



Defense Logistics Agency Working Capital Fund

Annual Financial Statements
Fiscal Year 2002
(Unaudited)

The Warfighter's Logistics Combat Support Agency





DLA Mission

To provide best value logistics support to
America's Armed Forces,
in peace and war...around the clock,
around the world.

DLA Vision

Right Item, Right Time, Right Place, Right Price.
Every Time...Best Value Solutions
For America's Warfighters.

DEFENSE LOGISTICS AGENCY

Annual Financial Statements Fiscal Year 2002

Defense Working Capital Fund

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Message from the Director

The Defense Logistics Agency is a dedicated partner of the Military Departments. As logistics professionals, we are committed to meeting the needs of the men and women who defend our nation. Now, more than ever, this mission is critical.

The events of 9-11 set in motion the wheels of transition and by October 7, 2001, as the President of the United States addressed our Nation and announced the beginning of Operation Enduring Freedom, we – as the Department's Logistics Combat Support Agency – were supporting this vital mission around-the-clock and around-the-world.

In the course of our efforts, we processed more than 720,000 requisitions, shipped nearly 700,000 materiel release orders, and provided more than 740 million gallons of fuel to the United States and Coalition Forces. We provided humanitarian aid as well, delivering more than 2 million pounds of wheat and more than 3½ million daily rations. Through our Contingency Support Teams, we provided direct support to forces on the ground. The members of these teams are deployed to theaters of operation to directly address all classes of supply issues and logistics concerns identified by the warfighters, including places such as Tajikistan and Kazakhstan.

While we are concentrating on supporting those on the front lines of the war against terrorism, we are continuing to make strides in transforming the Agency to maintain global logistics excellence in the 21st century. The successful launch of our Business Systems Modernization initiative on July 31, 2002 began our fundamental shift from managing items to supporting the customer. Our efforts in the Strategic Distribution Program have resulted in significant improvements in the performance of the Department of Defense supply chain. In addition, we have reduced backorders and trimmed customer wait time, while producing the lowest cost recovery rate in the Agency's history. We are meeting our customers face to face to understand their requirements and how we can best support them.



Looking back at the past year, this Agency has faced many challenges. Our people – whether they are a military service member, reservist, or a DoD civilian – have all met the challenges head-on with professionalism and ingenuity to fulfill the needs of our customers. In Fiscal Year 2003, we will continue to: learn more about our customers' plans, priorities, and program requirements; adapt and then refine our business practices to respond to their operational needs; and maintain the flexibility to anticipate their needs in a volatile and complex environment, so that we can continually provide the best value logistics solutions to America's warfighters—the right item, at the right time, in the right place, at the right price.

KEITH W. LIPPERT
Vice Admiral, SC, USN
Director

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Consolidated Overview

Defense Working Capital Fund

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DESCRIPTION OF THE DEFENSE LOGISTICS AGENCY

The Defense Logistics Agency (DLA) is a combat support agency of the Department of Defense (DoD) that receives oversight and staff direction from the Under Secretary of Defense for Acquisition, Technology, and Logistics. Our primary mission is to provide best value logistics solutions to meet the needs of America's armed forces around the clock and around the world, in times of peace, national emergency, and war. We are a dedicated partner to America's warfighters. Our reach extends from the home-front to the frontlines and from mess halls to foxholes. The U.S. national defense strategy has never been more dependent on the logistics support we provide than it is today. We support DoD objectives and missions through our involvement in the full range of military operations, from our participation in multi-national forces engaged in large-scale combat operations, peacekeeping, and humanitarian assistance, to the Global War on Terrorism.

We manage logistics information for over 4 million items and buy and ship materiel to where it is needed—everything from fuel and repair parts for weapon systems, to the food, clothing, and medical supplies needed to deploy and sustain U.S. forces. We also receive, issue, and distribute most DoD materiel through our network of supply depots; and we manage DoD programs to reutilize, transfer, donate or sell surplus and excess materiel, and dispose of hazardous materiel. As secondary missions, we manage the DoD document automation and production services and the National Defense Stockpile.

Our missions have evolved and grown over the past four decades to an extent that if our forces fight with it, wear it, eat it, or burn it as fuel, we probably buy it, warehouse and distribute it, and/or arrange for its reuse, sale or disposal after the owner no longer needs it.

Our Vision:

*Right Item, Right Time,
Right Place, Right Price. Every Time...Best
Value Solutions For America's Warfighters.*

Agency Strategic Goals and Strategies

We are actively engaged in the revolution of DoD business affairs, including the significant advances made in the technological sophistication, speed, and mobility of our armed forces. We are constantly adapting to the changing global logistics requirements, including the need to support smaller U.S. forces as they respond to crises around the world, often in remote regions where roads, airfields and seaports are primitive, if they exist at all. Our Strategic Plan provides a road map to our logistics transformation effort and supports the Office of the Assistant Deputy Under Secretary of Defense (Logistics and Materiel Readiness) efforts to accelerate logistics improvement and enhance support to the warfighter.

In FY 02, we amended our Strategic Plan and implemented a Balanced Scorecard (BSC) as a management tool to assist in the oversight of our transformation commitment; as well as identify and support DLA's corporate strategies, measures, targets, and initiatives. Our FY 02 report outlines the methodology as it relates to four quadrants of the Corporate BSC (Customer, Internal Process, Learning and Growth, and Financial) and DLA's Lead Center concept. We will continue to refine and improve our BSC metrics, as needed, to support DoD objectives.

Our Strategic Plan identifies DLA's four strategic goals:

Strategic Goals

- Provide responsive, best-value supplies and services consistently to our customers.
- Structure internal processes to deliver customer outcomes effectively and efficiently.
- Ensure our workforce is enabled and empowered to deliver and sustain logistics excellence.
- Manage DLA resources for best customer value.

We will achieve these strategic goals through a series of integrated enterprise-wide strategies.

Goal 1. Provide responsive, best value supplies and services consistently to our customers.

Strategy 1.1 Focus, manage, and measure logistics support by customer segment based on customer requirements.

Strategy 1.2 Negotiate and honor performance agreements with our customers.

Strategy 1.3 Ensure seamless logistics support to customer segments throughout the customer's transition to and from peace and war.

Goal 2. Structure internal processes to deliver customer outcomes effectively and efficiently.

Strategy 2.1 Improve supply chain effectiveness.

Strategy 2.2 Improve processes.

Strategy 2.3 Leverage industry.

Strategy 2.4 Design and implement a best value enterprise information technology (IT) environment.

Goal 3. Ensure our workforce is enabled and empowered to deliver and sustain logistics excellence.

Strategy 3.1 Deliver the proper knowledge and skills to meet DLA's commitments to our customers.

Strategy 3.2 Create and manage a customer-focused corporate culture.

Strategy 3.3 Provide a quality work environment consistent with DLA values.

Goal 4. Manage DLA resources for best customer value.

Strategy 4.1 Resource DLA's operational strategies.

Strategy 4.2 Minimize total supply chain costs.

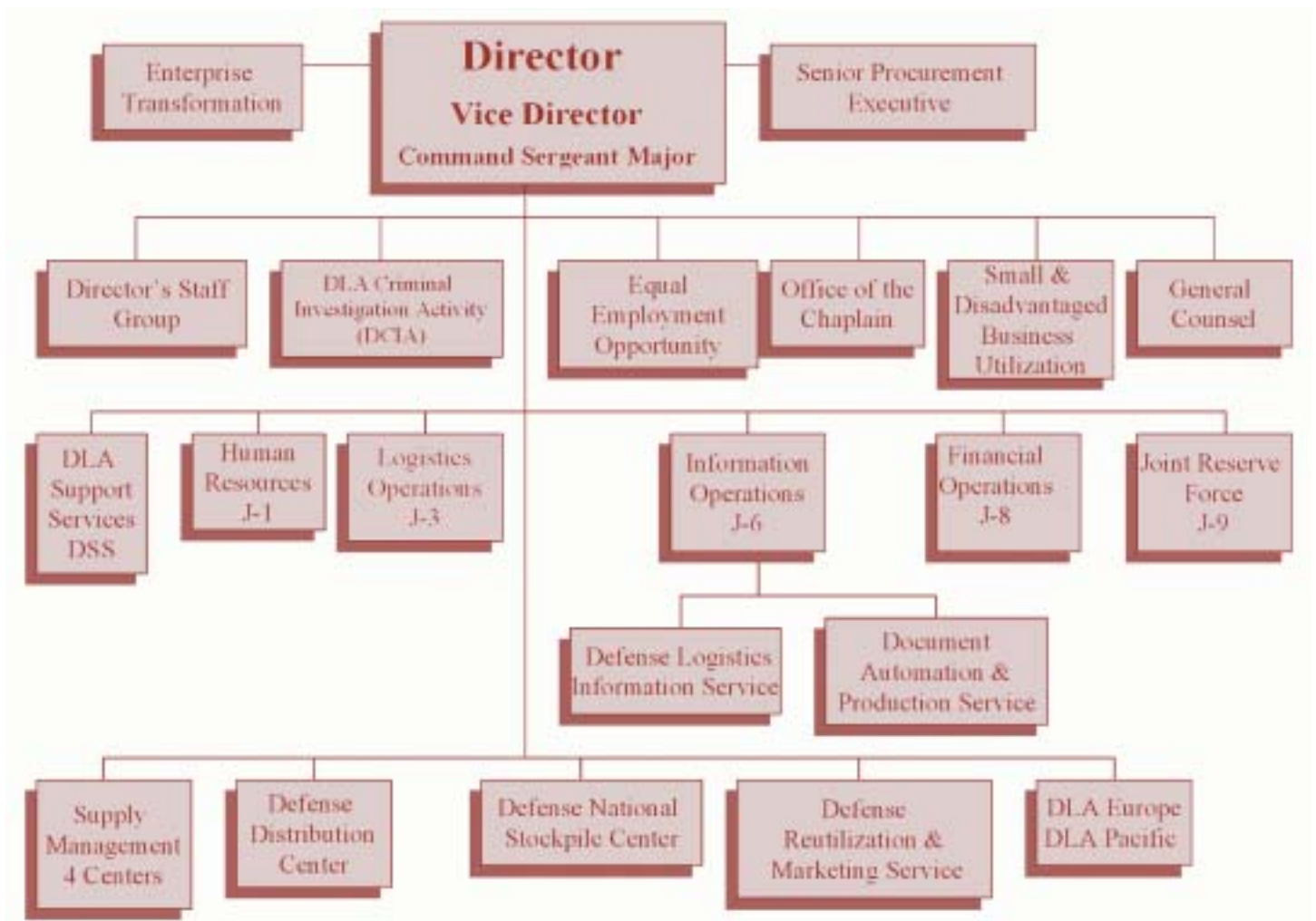
Strategy 4.3 Promote confidence in DLA's financial stewardship.

ORGANIZATION

DLA maintains a global presence with a civilian workforce of about 22,600 personnel and about 1,000 active duty and reserve military personnel. Despite our significant mission expansion over the last 40 years, our workforce is now at the smallest level since 1963 and we expect to reduce it even more. Agency leaders are committed to the continuous assessment and improvement of our organizational size, structure and alignment through enterprise integration and partnering with the private sector. The outcomes of these assessments will enable us

to implement an enterprise business model and develop, deploy and execute an improved set of corporate business processes and strategies. Organized as a single integrated business enterprise will position us to focus more on supply chain management, readiness, and contingency operations. Even more important, however, is the relationship we maintain with our customers. DLA is taking a more proactive approach to serving those who depend on us for their mission needs. We are meeting with our customers face to face to determine their requirements and how we can best support them.

Our organizational structure during FY 02 is depicted below:



DLA's core functions are directed or supported by:

- Human Resources (J-1) provides Agency personnel management services, including military and civilian personnel services. Field Activities of J-1 include the DLA Human Resources Center (HROC) and the DLA Training Center (DTC), both located in Columbus, OH.
- Logistics Operations (J-3) provides focused logistics support to America's Armed Forces. J-3 is responsible for logistics and acquisition policy; supply chain management, distribution, and reutilization; and the application of DLA readiness and customer support efforts. J-3 serves as the head of the logistics sector for the entire Department of Defense under the Critical Infrastructure Protection (CIP) Program mandated by the President. Logistics Operations encompasses supply management, distribution and reutilization and marketing.
- Information Operations (J-6) is DLA's knowledge broker and responsible for providing comprehensive, best practice technological support to the DoD/DLA logistics community resulting in the highest quality of information systems; efficient and economical computing; data management; electronic commerce; and telecommunication services. The Director, J-6, is responsible for the development and compliance of IT policy, development of IT plans and strategies, and establishment of IT standards, processes, and measurements. The Director, J-6, also serves as the Agency's Chief Information Officer. Information Operations encompasses oversight of three field activities: the Defense Logistics Information Service, the Defense Automatic Addressing System Center, and the Document Automation and Production Service.
- Financial Operations (J-8) is the Agency's financial management process owner. J-8 is responsible for designing and implementing standard financial processes across the Agency, determining financial services' resource requirements and performance targets, and establishing financial core competency requirements. The Comptroller serves as the Agency's Chief Financial Officer and as the single

spokesperson on financial management matters with external organizations.

- DLA Support Services (DSS) oversees common corporate/enterprise mission support such as corporate communications, environment and safety, installations, management support, corporate planning, quality of life, command security, protocol and special events, DLA Pacific support, and the DLA Chair, Industrial College of the Armed Forces, while providing operational support to Headquarters, DLA Activity Group Missions.
- Joint Reserve Forces (JRF) (J-9) supports DLA with trained, ready, and available reservists in contingency operations, peacetime contributory support, wartime surge support, and planning support; and advises the Director, DLA in development and application of JRF support and readiness policies and programs.

The Defense-wide Working Capital Fund (DWCF) is the primary source of funds for DLA operations. During FY 02, DLA executed a total budget program of about \$22.5 billion. The four DLA activity groups funded by the DWCF and included in these statements are Supply Management, Distribution, Reutilization and Marketing, and Document Automation and Production. Each year, DLA either obtains or returns funds to the DWCF and other DoD appropriations.

DLA also receives some direct appropriations (for purposes such as Military Construction) and manages the National Defense Stockpile Transaction Fund, a separate revolving fund. These funds (and related financial events) are not accounted for in these financial statements.

The following activity groups are financed by customer orders and direct appropriations through the DWCF:

Supply Management. The Supply Management activity group provides customer support through management of logistics processes. This includes centralized management of logistics information, energy, consumable spare parts, food, pharmaceuticals, medical and surgical supplies, and clothing and textiles. Supply Management operates through three supply centers located in Columbus, OH;

Richmond, VA; and Philadelphia, PA; and the Defense Energy Support Center located at Fort Belvoir, VA. The Supply Management activity group is the largest of our business areas. It makes up about 94 percent of the assets, 77 percent of liabilities, and 90 percent of revenue and costs on the financial statements.

Distribution. The Distribution activity group provides a single, unified materiel distribution system for DoD. In addition to its primary mission of receiving, storing and issuing materiel worldwide; distribution depots perform other functions that include, but are not limited to, providing refrigerated storage, cylinder refurbishment, tent repair, medical unit assemblies, minor maintenance, and set assembly or disassembly. The Distribution activity group is under the control of the Defense Distribution Center in New Cumberland, PA and includes 22 subordinate distribution centers located throughout the United States, Europe and in the Pacific region.

Reutilization and Marketing. The Reutilization and Marketing activity group supports and coordinates the reuse of excess and surplus property within DoD.

Property not reutilized within DoD is available for transfer to other Federal agencies or for donation to authorized non-profit organizations, state governments, and local governments. Property not reused, transferred or donated is either sold to the public on a competitive basis or disposed of in an environmentally safe manner. A critical part of the Reutilization and Marketing activity group's mission is to arrange for the worldwide disposal of hazardous waste and materiel. The activity group accomplishes its mission from a headquarters in Battle Creek, MI and 94 Defense Reutilization and Marketing Offices located on military installations around the world.

Document Automation and Production. The Document Automation and Production Service (DAPS) activity group provides document automation and printing within the DoD. This mission encompasses electronic conversion, retrieval, output and distribution of digital and hardcopy information. Its focus is on enabling DAPS customers to transition from hardcopy to digital/electronic-based document management. DAPS manages its worldwide mission through a headquarters, located in Mechanicsburg, PA, and a network of 80 major field locations and 176 smaller document automation facilities.

DLA DWCF ACTIVITY GROUP PRINCIPAL LOCATIONS



1. Defense Supply Center Columbus (DSCC)
2. Defense Supply Center Richmond (DSCR)
3. Defense Supply Center Philadelphia (DSCP)
4. Defense Energy Support Center (DESC)
5. Defense Distribution Center (DDC)
6. Defense Reutilization and Marketing Service (DRMS)
7. Document Automation and Production Service (DAPS)
8. Headquarters Defense Logistic Agency (HQ DLA)

FINANCIAL CONDITION

The financial statements have been prepared to report the financial position and results of operations for the Defense Logistics Agency, Defense-wide Working Capital Fund (DWCF), pursuant to the requirements of the Title 31, United States Code, Section 3515(d). While the statements have been prepared from the books and records of the Defense Logistics Agency, in accordance with the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

To the extent possible, the financial statements have been prepared in accordance with Federal accounting standards. At times, the DLA has not been able to implement all the elements of the standards due to financial management systems limitations. The statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that the liabilities cannot be liquidated without legislation that provides the resources to do so.

The DWCF was created to establish a customer-provider relationship between the military operating forces and support organizations, in order to improve delivery of support services while reducing the cost of operations. The financial structure of the DWCF allows for the identification of the full cost of activity groups and facilitates performance measures to foster efficiency and productivity improvements. This enables the customer to make economical buying decisions using timely and accurate financial information in the decision-making process. DLA evaluates monthly financial reports and makes appropriate adjustments in budget execution during the year to ensure that the activity groups are consistent with budget execution targets. Additionally, the financial data is used as a baseline for future budget requests and to establish prices.

The DLA DWCF finished the year with total assets valued at approximately \$14.4 billion, liabilities of \$2.3 billion, and net operating results of \$1.5 billion on

program costs of about \$20.3 billion and earned revenue of about \$21.8 billion. The net position included approximately \$237 million of prior period expenses that were treated as current period expenses (per OSD policy) and about \$120 million in imputed expenses, such as retirement costs not paid by the DWCF. The improvement in net position of about \$2.5 billion included about \$1.4 billion in prior period adjustments to reflect the change in inventory valuation directed by the DoD Comptroller (see footnote No. 7 for details).

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

The DLA system of internal accounting and administrative controls, in effect during the fiscal year ended September 30, 2002, was evaluated in accordance with the guidance in Office of Management and Budget (OMB) Circular No. A-123, Management Accountability and Control, dated June 21, 1995, as implemented by DoD Directive 5010.38, Management Control Program, dated August 26, 1996 and DoD Instruction 5010.40, Management Control Program Procedures, dated August 28, 1996. The OMB guidelines were issued by the OMB Director, in consultation with the Comptroller General of the United States, as required by the Federal Managers' Financial Integrity Act of 1982. Included is an evaluation of whether the system of internal accounting and administrative control of DLA is in compliance with the standards prescribed by the Comptroller General.

Systems

For most of its history, DLA performed its complex, worldwide logistics mission with strong command and control lines along multiple business segments and programs. Over time, this led to "stovepipe" organizations that developed their own automated management (legacy) information systems and accounting processes.

While these business practices worked well to serve the customer, they also produced a fragmented and very complex set of accounting processes and financial systems

that often resulted in different accounting methods and systems used to account for essentially the same types of transactions. As part of our logistics transformation initiatives, we will dramatically improve the accuracy, timeliness, and relevance of the financial management data maintained in our logistics systems.

The Defense Finance and Accounting Service (DFAS) prepared the FY 02 DLA financial statements from available finance, accounting, and feeder systems (such as acquisition, logistics, and personnel systems) and manual processes. Most of the automated systems were designed decades before the current Federal accounting standards were developed, making it difficult to collect - from the legacy systems - the data needed to prepare financial statements that comply with Federal standards. Additionally, there is often insufficient documentation available showing how financial transactions are processed through the systems, making it very difficult to audit the financial statements and for DLA to demonstrate a high level of internal controls and compliance with pertinent financial laws and regulations. Other data comes from DFAS systems that are neither linked with DLA systems nor can pass data easily among other DFAS systems.

DLA has a multitude of short- and long-term efforts designed to fully assess its financial operations and to develop integrated systems and processes that are compliant with Federal system and accounting requirements. Some of our major strategies include:

- Upgrade the DLA logistics management systems (supply/non-energy) through the Business Systems Modernization (BSM) initiative. BSM is designed to improve business practices and replace aging legacy logistics systems with commercial-off-the-shelf (COTS) enterprise resource planning software. The software is compliant with Federal Financial Management Improvement Act requirements. BSM is expected to cut costs, eliminate systemic mistakes and provide the necessary audit trails to demonstrate financial stewardship. The initial release, called “concept demonstration,” began processing customer orders on August 1, 2002 using the BSM tools and re-engineered processes for about 170,000 selected

items. The Agency plans to bring the balance of its products into the BSM system by 2005.

- The fuel legacy system is also being upgraded to a COTS package, the Fuel Automated System (FAS). The new system is expected to have full operational capability by 2005.
- Efforts are underway to identify, assess, and remediate other critical DLA-owned legacy systems. Our primary focus in FY 03 will be on the FAS and the Distribution Standard System. Additionally, we will work with the DoD-wide Financial Management Enterprise Architecture (FMEA) team to improve our systems and business practices.
- During FYs 00 and 01, we contracted with a commercial sector firm to audit our Consolidated Balance Sheet funded by the DWCF. In both years, we received a disclaimer of opinion. Major deficiencies included noncompliant automated systems, control weaknesses in key business and financial processes, and deficiencies in our service provider financial compilation and system security processes. Based on the audit results and the provisions of Section 1006 of the National Defense Authorization Act for Fiscal Year 2002 (Public Law 107-107) and related guidance issued by the DoD Comptroller, DLA shifted its strategy from an audit to an auditability assessment. The legislation and related DoD guidance requires that if DLA management determines that its financial statements will be unreliable (i.e., probability of obtaining an unqualified audit opinion was unlikely), then it must redirect the resources previously used to develop, compile, and report the financial statements to identifying and improving financial management policies, procedures, internal controls, and systems. DLA management determined that a “clean” audit opinion is unlikely before FY 07 and therefore shifted to an audit assessment strategy. In FY 02, we focused on 10 improvement areas. The DLA Audit Committee provides continuous oversight of the assessment project and the 10 targeted improvement areas.

- During FY 02, DLA continued to institutionalize and formalize its compliance process. The process encompasses all elements of deficiency resolution: acceptance, solution development, implementation, and validation. DLA's strategy is to improve its business processes, automated systems, and controls; and thereby generate more timely, complete, and accurate financial information. DLA developed a Compliance Plan that documents known audit deficiencies and the approved action plans to correct them. Action plans will be maintained by DLA internal audit in a central database repository for update and tracking purposes. The DLA Audit Committee provides oversight over the compliance process and progress is reported as part of the DLA Balanced Scorecard to the DLA Corporate Board quarterly. Furthermore, as new business processes are developed, they will be formally documented and included in the DLA One Book.
- Obligations and costs are in compliance with applicable laws.
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- Revenues and expenditures applicable to Agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial, and statistical reports.
- Accountability over the assets is maintained.

The evaluation was performed in accordance with the guidelines identified above. The results indicate that the system of internal accounting and administrative control of DLA in effect during the fiscal year that ended September 30, 2002, taken as a whole, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved. This position on reasonable assurance is within the limits described in the preceding paragraphs.

Highlights presented in the FY 2002 Annual Statement of Assurance:

- Progress Made Toward Institutionalizing the DLA Management Control (MC) Program.
 - o The Headquarters Business Offices and DLA Field Activities continued to make progress in expanding the requirement to report material weaknesses and internal control issues within their respective organizations. To improve the reporting consistency and assist auditors in their review, DLA standardized the assessment letters used throughout the Agency. In addition, the DLA MC Program "How To" Guide was revised and made available to all DLA MC Program Managers. Among the changes are: (1) charts to more clearly illustrate how the MC Program interrelates with other DLA programs to accomplish DLA's mission; and (2) step-by-step procedures for developing control objectives and techniques.

Management Controls

The evaluation of management controls extends to every responsibility and activity undertaken by DLA and is applicable to financial, administrative, and operational controls. Furthermore, the concept of reasonable assurance recognizes that: (1) the cost of management controls should not exceed the benefits that are expected to be derived; and (2) the benefits consist of reductions in the risks of failing to achieve the stated objectives. The expected benefits and related costs of control procedures should be addressed using estimates and managerial judgment. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. Finally, projection of any evaluation of the system to future periods is subject to risk that procedures may be inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

The objectives of the system of internal accounting and administrative control of DLA are to provide reasonable assurance that:

- o The DLA MC team developed a useful, interesting, and relevant course for new DLA MC program managers. It incorporated the most relevant Federal guidance, websites, DLA samples and guidance, and some real-life examples/news stories of both good and bad controls. This course was taught for the first time in June 2002; and the students provided enthusiastic and positive evaluations.
- o DLA also developed core objectives for inclusion in all applicable FY 03 management control plans.
- o Field Activities provided electronic versions of local guidance to enable the control objective managers to perform better assessments.
- o The DRMS Management Control Program was fully implemented.
- We made improvements to the FY 02 financial statements and compilation process by:
 - o Improving the timeliness of the financial statements and met the accelerated reporting requirements;
 - o Resolving \$176 million in unsupported accounting adjustments posted previously;
 - o Resolving past judgment fund payments totaling over \$6 million;
 - o Researching accounts receivable balances and establishing an allowance account;
 - o Eliminating over \$250 million in overage accounts payable, and;
 - o Improving the reporting of environmental and contingent Liabilities.

Despite these improvements, the financial statements are not yet auditable. Our inability to obtain a favorable audit opinion on our financial statements is included in the Annual Statement of Assurance as a material weakness.

While matters regarding systems, management controls, and legal compliance are addressed in these financial statements, additional detail about management controls is

provided in the DLA FY 2002 Annual Statement of Assurance.

OTHER ACCOMPANYING INFORMATION

From December 2001 to June 2002 the Joint Chiefs of Staff (JCS) Combat Support Agency Review Team (CSART) assessed the readiness and responsiveness of DLA's support to the operating forces. While the CSART praised the overall DLA operations, there were findings pertaining to combat readiness.

The CSART evaluated DLA's support to recent and on-going contingencies as a major indicator of its future performance and readiness. Based upon the performance of the Agency in these contingency operations, the CSART found that DLA appears fully capable of supporting similar contingency operations and was complementary with respect to our bulk fuel and subsistence support. However, none of these contingencies stressed the logistic supply chain as might be expected in support of a major conflict. The CSART reported a number of significant findings; and in response, DLA intends to meet its commitments by:

- Increasing the number of DLA Liaison Officers (LNOs). DLA will establish, train, and exercise a cadre of LNOs that are immediately available to augment the current LNO support at a combatant command in the event of a crisis or contingency when around-the-clock coverage is needed.
- Securing DLA communications. The Joint Staff J-6, in coordination with DLA and DISA, will develop and implement a secure communications plan to reduce the secure communications shortfalls and operational risks.
- Managing delivery risk. To create a more efficient logistics pipeline, DLA is embracing commercial delivery concepts. However, these delivery concepts increase the logistic risk in theaters with undeveloped commercial transportation hubs. In response, DLA will manage the delivery risk by:

identifying theaters where undeveloped commercial infrastructure limits delivery options; presenting a concept of logistic support for those areas; and incorporating that concept into the logistic support plan.

- Reducing medical materiel readiness risk. Exclusive reliance upon medical prime vendor suppliers increases the risks of not meeting surge requirements for a large-scale contingency. To address this concern, DLA will develop broad scope medical prime vendor contracts; and develop and execute simulated medical exercises to test and assess the medical prime vendor surge capability.
- Defending commercial information operations. DLA's logistics model relies on vendors and their information systems to maintain inventories and provide timely delivery. A successful computer network attack against DLA's vendors would hinder its ability to procure and distribute supplies to the warfighter. In response to this concern, DLA will conduct an information operations risk assessment of its commercial vendor base to determine DoD's vulnerability and develop the requisite mitigation strategies.
- Providing aviation repair parts. At 87.6 percent, DLA exceeds the DoD's aggregate 85 percent supply availability goal, which is a 2.6 percentage improvement from the level reported in the 2000

CSART. Nonetheless, DLA faces three challenges that may prevent them from maintaining that support level. First, unanticipated demand for aircraft repair parts can result in parts shortages. Second, contractual delays may hinder the on-time delivery of repair parts to DLA. Third, the price of aircraft parts can escalate faster than the budget to cover those escalating prices. In response, DLA will ensure that its support strategy and implementation plan continually improves stocking policies, forecasting models, and contractor delivery performance for aviation repair parts to maintain the DoD 85 percent supply availability goal.

In addition, to the findings outlined above, the CSART reported:

- Praise in providing bulk fuel support. The combatant commands praised DLA and its field level activity, the Defense Energy Support Center, for its fuel support.
- Success in providing subsistence support. DLA's use of prime vendors to provide the majority of its subsistence support to the operating forces has been extremely successful.

In response to the findings highlighted above, each deficiency was assigned to its responsible HQ DLA organization and the supporting field activities to correct and report the status of each deficiency.

Consolidated and Combined Financial Statements

**AS OF AND FOR THE YEARS ENDED
SEPTEMBER 30, 2002 AND 2001**

Defense Working Capital Fund

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Unaudited

Consolidated Balance Sheets
As of September 30, 2002 and 2001
(In Thousands)

	2002 Consolidated	2001 Consolidated As Restated (Note 19)
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ -	\$ -
Accounts Receivable (Note 4)	832,212	692,660
Other Assets (Note 5)	<u>244</u>	<u>240</u>
Total Intragovernmental Assets	832,456	692,900
Cash and Other Monetary Assets (Note 6)	4,390	5,429
Accounts Receivable (Note 4)	457,931	286,748
Inventory and Related Property (Note 7)	11,535,642	11,007,801
General Property, Plant and Equipment (Note 8)	1,303,793	1,216,122
Other Assets (Note 5)	<u>224,735</u>	<u>230,175</u>
TOTAL ASSETS	<u>\$ 14,358,947</u>	<u>\$ 13,439,175</u>
LIABILITIES (Note 9)		
Intragovernmental:		
Accounts Payable (Note 10)	\$ 142,959	\$ 100,849
Environmental Liabilities (Note 11)	-	-
Other Liabilities (Note 12 and Note 13)	<u>47,889</u>	<u>53,781</u>
Total Intragovernmental Liabilities	190,848	154,630
Accounts Payable (Note 10)	1,648,381	1,865,469
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities (Note 14)	199,990	245,648
Environmental Liabilities (Note 11)	-	-
Other Liabilities (Note 12 and Note 13)	<u>298,152</u>	<u>306,108</u>
TOTAL LIABILITIES	<u>2,337,371</u>	<u>2,571,855</u>
NET POSITION		
Unexpended Appropriations	<u>-</u>	<u>-</u>
Cumulative Results of Operations	12,021,576	10,867,320
TOTAL NET POSITION	<u>\$ 12,021,576</u>	<u>\$ 10,867,320</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 14,358,947</u>	<u>\$ 13,439,175</u>

See notes to the consolidated and combined financial statements.

Unaudited

Consolidated Statements of Net Cost
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Consolidated	2001 Consolidated
Program Costs		
Intragovernmental Gross Costs	\$ 1,572,852	\$ 987,535
Less: Intragovernmental Earned Revenue	<u>(19,435,245)</u>	<u>(16,398,587)</u>
Intragovernmental Net Costs	(17,862,393)	(15,411,052)
Gross Costs With the Public	17,766,343	16,874,366
Less: Earned Revenue From the Public	<u>(1,399,248)</u>	<u>(1,113,976)</u>
Net Costs With the Public	<u>16,367,095</u>	<u>15,760,390</u>
Total Net Cost	<u>(1,495,298)</u>	<u>349,338</u>
Net Cost of Operations	<u>\$ (1,495,298)</u>	<u>\$ 349,338</u>

See notes to the consolidated and combined financial statements.

Unaudited

Consolidated Statements of Net Position
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Cumulative Result of Operations	2002 Unexpended Appropriations	2001 Cumulative Results of Operations As Restated (Note 19)	2001 Unexpended Appropriations
Beginning Balances	\$ 10,867,320	\$ -	\$ 9,111,377	\$ 1,556,200
Budgetary Financing Sources:				
Appropriations received	-	-	-	(1,556,200)
Appropriations transferred-in/out	-	75,000	-	-
Appropriations used	75,700	(75,000)	1,558,879	-
Other budgetary financing sources	4,636	-	(128,858)	-
Other Financing Sources:				
Transfers-in/out without reimbursement	(542,298)	-	552,721	-
Imputed financing from costs absorbed by others	<u>120,920</u>	<u>-</u>	<u>122,539</u>	<u>-</u>
Total Financing Sources	(341,042)	-	2,105,281	(1,556,200)
Net Cost of Operations	<u>(1,495,298)</u>	<u>-</u>	<u>349,338</u>	<u>-</u>
Ending Balances	<u>\$ 12,021,576</u>	<u>\$ -</u>	<u>\$ 10,867,320</u>	<u>\$ -</u>

See notes to the consolidated and combined financial statements.

Unaudited

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Combined	2001 Combined
Budgetary Resources:		
Budget Authority:		
Appropriations received	\$ 75,700	\$ 2,679
Contract authority	335,738	1,854,667
Unobligated balance:		
Beginning of period	532,016	1,426,506
Net transfers, actual	-	(915,300)
Spending authority from offsetting collections:		
Earned		
Collected	21,007,872	18,198,173
Receivable from Federal sources	358,247	(260,862)
Change in unfilled customer orders		
Advance received	(13,994)	(1,420)
Without advance from Federal sources	226,053	75,197
Subtotal	21,578,178	18,011,088
Recoveries of prior year obligations	31	-
Permanently not available	(18,095)	(1,267,195)
Total Budgetary Resources	<u>\$ 22,503,568</u>	<u>\$ 19,112,445</u>
Status Of Budgetary Resources:		
Obligations incurred:		
Direct	\$ -	\$ (2,454,908)
Reimbursable	21,662,810	21,035,337
Subtotal	21,662,810	18,580,429
Unobligated balance:		
Apportioned	840,758	532,016
Total, Status of Budgetary Resources	<u>\$ 22,503,568</u>	<u>\$ 19,112,445</u>
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	\$ 6,643,099	\$ 6,621,808
Obligated Balance, Net - end of period:		
Accounts receivable	(1,491,369)	(1,133,123)
Unfilled customer orders from Federal sources	(1,955,234)	(1,729,179)
Undelivered orders	8,313,599	7,113,413
Accounts payable	2,258,769	2,391,988
Outlays:		
Disbursements	20,595,814	18,744,803
Collections	(20,993,879)	(18,196,753)
Subtotal	(398,065)	548,050
Net Outlays	<u>\$ (398,065)</u>	<u>\$ 548,050</u>

See notes to the consolidated and combined financial statements.

Unaudited

Consolidated Statements of Financing
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Consolidated	2001 Consolidated
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	\$ 21,662,810	\$ 18,580,429
Less: Spending authority from offsetting collections and recoveries	(21,578,209)	(18,011,089)
Obligations net of offsetting collections and recoveries	84,601	569,340
Net obligations	84,601	569,340
Other Resources		
Transfers in/out without reimbursement	2,045	-
Imputed financing from costs absorbed by others	120,920	122,539
Net other resources used to finance activities	122,965	122,539
Total resources used to finance activities	207,566	691,879
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided:		
Undelivered Orders	(1,194,234)	67,460
Unfilled Customer Orders	212,060	73,778
Resources that fund expenses recognized in prior periods	(54,503)	(7,652)
Resources that finance the acquisition of assets	(690,365)	(443,876)
Other	24	(139,230)
Total resources used to finance items not part of the net cost of operations	(1,727,018)	(449,520)
Total resources used to finance the net cost of operations	(1,519,452)	242,359
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	8,013	-
Increase in exchange revenue receivable from the the public	-	(316)
Other	-	13,741
Total components of Net Cost of Operations that will require or generate resources in future periods	8,013	13,425
Components not Requiring or Generating Resources		
Depreciation and amortization	155,960	98,724
Revaluation of assets or liabilities	(167,993)	-
Other	28,174	(5,170)
Total components of Net Cost of Operations that will not require or generate resources	16,141	93,554
Total components of Net Cost of Operations that will not require or generate resources in the current period	24,154	106,979
Net Cost of Operations	\$ (1,495,298)	\$ 349,338

See notes to the consolidated and combined financial statements.

Notes to the Consolidated and Combined Financial Statements

**AS OF AND FOR THE YEARS ENDED
SEPTEMBER 30, 2002 AND 2001**

Defense Working Capital Fund

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Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements were prepared to report the financial position, net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary resources of the Defense Logistics Agency (DLA) that are financed by the Defense-wide Working Capital Fund (DWCF), as required by the Chief Financial Officers (CFO) Act of 1990, expanded by the Government Management Reform Act (GMRA) of 1994, and other pertinent legislation. It does not include DLA operations funded through direct or general appropriations; or the Stockpile, which is a nonworking capital revolving fund. The financial statements were prepared from DLA and DFAS books and records according to the “Department of Defense Financial Management Regulation” (DoD FMR) as adapted from the Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and to the extent possible Federal generally accepted accounting principles (Federal GAAP).

The DLA is unable to fully implement all elements of Federal GAAP and OMB Bulletin No. 01-09 due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Preparing reliable financial statements also depends on the adequacy of the systems and processes used by DFAS, which are also not fully compliant with Federal accounting and system requirements. Reported values and information for the DLA major asset and liability categories are derived largely from non-financial feeder systems, such as acquisition, property, and logistic systems. These systems were designed to support reporting requirements that focused on asset accountability and funds control rather than to support the preparation of financial statements. The DLA and DFAS continue to implement process and system improvements to address the system and process limitations.

1.B. Mission of Reporting Entity

The DLA mission is to provide the best value logistics solution to meet the needs of America’s Armed Forces around the clock and around the world, in times of peace, national emergency, and war. Support begins with joint

planning for parts used in new weapons systems, extends through production and contract support, distribution and warehousing, and concludes with the disposal of materiel that is obsolete, worn out, or no longer needed. DLA provides supply support, technical/logistics services and quality support to all branches of the military. The services it provides fall into the following WCF activity groups: Supply Management, Distribution, Reutilization and Marketing Service (DRMS), and the Document Automation and Production Service (DAPS). DLA’s WCF is part of the DWCF, which includes other Defense Agencies.

1.C. Appropriations and Funds

DLA received its initial working capital through an appropriation or a transfer of resources from existing appropriations or funds and used those resources to finance the initial cost of products and services. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders and other sources. Receipts derived from operations generally are available in their entirety for use without further congressional action.

The DWCF operates with financial principles that provide improved cost visibility and accountability to enhance business management and improve the decision-making process. The Fund builds on revolving fund principles previously used for industrial and commercial type activities.

The asset accounts on the statements are categorized as either entity or nonentity. Entity assets consist of resources that the Agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Nonentity accounts are assets that are held by an entity but are not available for use in the operations of the entity.

1.D. Basis of Accounting

DLA generally records transactions on an accrual basis of accounting as required by Federal GAAP. However, some of the financial and nonfinancial feeder systems and processes used to prepare the financial statements are not designed to collect and record financial information on the accrual accounting basis. Efforts are underway to

determine the actions required to bring financial and non-financial feeder systems and processes into compliance with Federal GAAP. Until such time that the accounting processes and systems are updated, some of the DLA's financial data will be based on budgetary data, data calls, and information derived from nonfinancial feeder systems.

1.E. Revenues and Other Financing Sources

Exchange revenue is recognized at the point when rendered services are completed and billed, or at the point where inventory items are sold. Certain distribution activity group revenues are recognized based on the actual workload for the period. These revenues may be billed up to two months after work is performed. These financial statements include an adjustment to accrue these billings. Revenue is not earned to offset costs incurred by the DRMS transfer and donation programs.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because the DLA's financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses and accounts payable. Expenditures are recognized as expenses in the DLA's operations when depreciated in the case of PP&E or consumed in the case of OM&S. Certain expenses, such as civilian and military leave earned but not taken, are financed in the period in which payment is made.

Operating expenses were adjusted as a result of the elimination of balances between DoD Components. See Note 15.D, *Intragovernmental Revenue and Expense*, for disclosure of adjustment amounts.

1.G. Accounting for Intragovernmental Activities

The DLA, as an agency of the Federal government, interacts with and is dependent upon the financial activities of the Federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the DLA as though the Agency is a stand-alone entity.

The DLA's proportionate share of public debt and related expenses of the Federal government are not included. Debt issued by the Federal government and the related costs are not apportioned to Federal agencies. The DLA financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through budget appropriations. To the extent that this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

DLA civilian employees participate in the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), while the Military Retirement System (MRS) covers military personnel. Additionally, employees and personnel covered by FERS and MRS also have varying coverage under Social Security. The DLA funds a portion of the civilian and military pensions. Reporting civilian pension under CSRS and FERS retirement systems is the responsibility of the Office of Personnel Management (OPM). The DLA recognizes an imputed expense for the portion of civilian employee pensions and other retirement benefits funded by the OPM in the Statement of Net Cost and recognizes corresponding imputed revenue from the civilian employee pensions and other retirement benefits in the Statement of Changes in Net Position.

The Department reports the assets, funded actuarial liability, and unfunded actuarial liability for the military personnel in the Military Retirement Fund (MRF) financial statements. The Department recognizes the actuarial liability for the military retirement health benefits in the Other Defense Organization column of the DoD Agency-wide consolidating/combining statements.

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred

for benefits for DLA employees under FECA are administered by the Department of Labor and are ultimately paid by DLA.

The DLA, as a component of the Defense Department, interacts with the Treasury Department and OUSD(C) to determine possible claims in the Judgment Fund against DLA funds. DLA established a process whereby cases provided by the Treasury are researched, documented and recorded to the DLA financial statements, when there is credible evidence of a claim.

To prepare reliable financial statements, transactions occurring between entities within DLA or between DLA and other DoD activities and other Federal agencies must be eliminated. However, the DoD cannot accurately identify all intragovernmental transactions by customer. The DFAS is responsible for eliminating transactions between entities within DLA or between DLA and other DoD activities and other Federal agencies. In prior years, the DLA provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side departmental accounting offices, and DFAS adjusted the buyer-side records to recognize unrecorded costs and accounts payable. Likewise, DFAS adjusted DLA records based on the seller-side balances it obtained from other DoD activities. Internal DoD intragovernmental balances were then eliminated to the extent possible.

1.H. Transactions with Foreign Governments and International Organizations

Each year, the DoD Components sell defense articles and services to foreign governments and international organizations, primarily under the provisions of the “Arms Export Control Act of 1976.” Under the provisions of the Act, the Department has authority to sell defense articles and services to foreign countries and international organizations, generally at no profit or at a loss to the U.S. Government. Customers may be required to make payments in advance.

1.I. Funds with the U.S. Treasury

The financial resources of the DWCF are maintained in U.S. Treasury accounts. Cash collections, disbursements,

transfers, and adjustments are processed worldwide at DFAS, Military Services, General Services Administration (GSA), U. S. Army Corps of Engineers (USACE), and by the Department of State financial service centers. Each disbursing station prepares monthly reports, which provide information to the U. S. Treasury on check issues, electronic funds transfers, interagency transfers and deposits. Additionally, the DFAS centers submit reports to Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Treasury records this information to the applicable appropriation Fund Balance With Treasury (FBWT) account that they maintain. DLA’s funds are maintained at the Treasury within appropriation 97 X 4930.005.

Periodically, OUSD(C) authorizes cash transfers between services within the DoD WCF as well as with general fund corpuses. These transfers are recorded in DLA’s FBWT preclosing financial statements, but since DWCF reporting entities do not maintain FBWT at the DLA or activity level, these amounts are transferred to the component financial statements maintained at the DoD level (97 X 4930.005). These amounts are then included with the other Defense Agency funds in this appropriation. Material disclosures are provided at Note 3, *Fund Balance with Treasury*. Differences between accounting offices detail-level records and Treasury’s FBWT accounts are disclosed in Note 17.B, specifically, differences caused by in-transit disbursements and unmatched disbursements (which are not recorded in the accounting offices detail-level records).

1.J. Foreign Currency

DLA conducts a portion of its operations overseas within the DWCF. Any gains or losses incurred from Foreign Currency Fluctuation are accounted for during the rate development process.

1.K. Cash and Other Monetary Assets

DRMS receives bid deposits, which are recorded and held in suspense account X6501. At the time the appropriate bid selection is awarded, these funds are returned to the bidder(s).

1.L. Accounts Receivable

As presented in the Balance Sheet, accounts receivable include accounts, claims, refunds, and taxes receivable from other Federal entities or from the public and are considered entity assets. The DoD does not recognize an allowance for estimated uncollectible amounts from another Federal agency. Claims against another federal agency will be resolved between the agencies. For public accounts receivable, DLA has adopted the General Reserve Method, which is a formula to determine an estimated allowance for doubtful accounts. This was determined by the Department to be the most suitable approach for Defense Agencies to determine uncollectible accounts receivable. One component of the Supply Management activity established an allowance for doubtful account and corresponding bad debt expense account in FY 2001. Remaining DLA activities initially established allowance for doubtful and bad debt expense accounts in FY 2002. Material disclosures are provided in Note 4, *Accounts Receivable*.

1.M. Inventories and Related Property

Inventories are reported at approximate historical cost based on Latest Acquisition Cost (LAC) adjusted for holding gains and losses. The LAC method is used because inventory data is maintained in logistics systems designed for materiel management purposes. For the most part, these systems value inventory at LAC, and the reported amounts must be adjusted to approximate historic cost. DFAS, at the direction of the OUSD(C), uses a formula to estimate the approximate historical cost of DLA inventories.

Beginning with the preparation of the fiscal year 2002 financial statements, the Department will no longer use the Supply System Inventory Report as the basis for its financial presentation of excess, obsolete, and unserviceable inventory based upon the August 12, 2002 memorandum from OUSD(C). The account, "Excess, Obsolete, and Unserviceable" (United States Government Standard General Ledger (USSGL) 1524 for Working Capital Funds) will be populated by materiel in condition codes H (Unserviceable; Condemned), P (Unserviceable; Reclamation), S (Unserviceable; Scrap) or V (Unserviceable; Waste, Military Munitions), as defined by the Military Standard Transaction Reporting and

Accounting Procedures Manual (DoD 4000.25-2-M). This method complies with the Federal Financial Management Improvement Act of 1996, which requires use of the USSGL at the transaction level. Material disclosures related to inventory and related property are provided in Note 7, *Inventory and Related Property*.

1.N. General Property, Plant and Equipment

General Property, Plant, and Equipment (PP&E) are valued at historical acquisition cost plus capitalized renovations or improvements. General PP&E assets are capitalized at cost if the acquisition is \$100,000 or more and has a useful life of two or more years. All General PP&E other than land is depreciated on a straight-line basis. For WCF activities, all PP&E used in the performance of their mission is categorized as General PP&E, whether or not it meets the definition of any other PP&E categories. Heritage Assets are reported as Supplemental Stewardship information. USC Title 10 prohibits DoD Agencies from owning property; therefore DoD has expanded the recognition criteria of SFFAS No. 6 to more accurately report the financial position of its member agencies in accordance with DoD regulations. Defense Agencies recognize capital assets when they are deemed to be the predominant user of the asset. In those instances where original acquisition costs of General PP&E were not available, estimates have been used. Such estimates are based on either (1) the cost of similar assets at the time of acquisition or (2) the current cost of similar assets discounted for inflation to the time of acquisition.

The DLA financial feeder systems, its policies, and processing procedures do not adequately account for internal use software costs in accordance with SFFAS No. 10, "Accounting for Internal Use Software." The Office of the Under Secretary of Defense, Comptroller (OUSDC) has also acknowledged that the Department's financial systems (and component financial feeder systems) do not meet the provisions of SFFAS No. 10 in capturing cost at the appropriate detail level. The systems supported or owned by DLA fall into this category. DLA is participating in the OUSD-led working group established to address the Department's inability to comply with this Standard.

The OUSD working group is developing standard policies, procedures and guidelines for capturing the costs of internal use software. When OUSD completes its work and issues guidance, DLA will comply with the provisions promulgated. HQ DLA will subsequently issue policy guidance to its business offices and its field activities. Such guidance may require changes to existing or emerging DLA systems and will require manual work-around procedures until all systems are capable of capturing the information at the appropriate level.

Material disclosures are provided in Note 8, *General Property, Plant, & Equipment, Net*.

1.O. Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as advances or prepayments and reported as an asset on the Balance Sheet. Advances and prepayments are recognized as expenditures and expenses when the related goods and services are received.

1.P. Leases

Generally, lease payments are for the rental of equipment, space, and operating facilities and are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) and the value equals or exceeds the current DoD capitalization threshold, the applicable asset and liability are recorded. The amount recorded is the lesser of the present value of the rental and other lease payments during the lease term, excluding that portion of the payments representing executory costs paid to the lesser, or the asset's fair value. Leases that do not transfer substantially all of the benefits or risks of ownership are classified as operating leases and recorded as expenses as payments are made over the lease terms. DLA currently does not have the necessary policies, procedures, or systems in place to obtain this data.

1.Q. Other Assets

The DLA conducts business with commercial contractors under two primary types of contracts—fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that these long-term contracts can cause, the DLA provides financing payments. One type of

financing payment that the DLA makes is based on percentage of the work completed. In accordance with the SFFAS No. 1, Accounting for Selected Assets and Liabilities, such payments are treated as construction in process and are reported on the General PP&E line and in Note 8, *General PP&E, Net*. In addition, based on the provision of the Federal Acquisition Regulation, the DLA makes financing payments under fixed price contracts that are not based on a percentage of completion. The DLA reports these financing payments as advances or prepayments in the “Other Assets” line item because they become a DLA liability only after the contractor delivers the goods in conformance with the contract terms. If the contractor does not deliver a satisfactory product, the DLA is not obligated to reimburse the contractor for its costs, and the contractor is liable to repay the DLA for the full amount of the advance. The Department has completed a review of all applicable Federal accounting standards; applicable public laws on contract financing; Federal Acquisition Regulation Parts 32, 49, and 52; and the OMB guidance in 5 Code of Federal Regulations Part 1315, “Prompt Payment.” The Department has concluded that SFFAS No. 1 does not fully or adequately address the subject of progress payment accounting and is considering what further action is appropriate.

Material disclosures are provided in Note 5, *Other Assets*.

1.R. Accounts Payable

Intragovernmental Accounts Payable consists of amounts owed to other Federal agencies for goods or services ordered and received but not yet paid. Interest, penalties and administrative fees are not applicable to intragovernmental payables only. Non-Federal Payables (to the Public) are payments to non-Federal government entities.

Material disclosures are provided in Note 10, *Accounts Payable*.

1.S. Contingencies and Other Liabilities

As amended by SFFAS No. 12, the SFFAS No. 5, “Accounting for Liabilities of the Federal Government,” defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss to the DLA. The uncertainty will be

resolved when one or more future events occur or fail to occur. A loss contingency is recognized as a liability when it is probable that the future event or events will confirm the loss or the incurrence of a liability for the reporting entity and the amount of loss can be reasonably estimated. Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility that a loss or additional loss will be incurred. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, possible claims and assessments. The DLA's loss contingencies arising from pending or threatened litigation or claims and assessments occur due to events such as vehicle accidents, property or environmental damages, and contract disputes.

Material disclosures are provided in Note 12, *Other Liabilities*, and Note 13, *Commitments and Contingencies*.

1.T. Accrued Leave

Civilian annual leave and military leave are accrued as earned, and the accrued amounts are reduced as leave is taken. The balances for annual and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates.

1.U. Net Position

DLA's net position consists of unexpended appropriations and cumulative results of operations. Unexpended appropriations represent amounts of authority, which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which legal liabilities for payments have not been incurred. Cumulative results of operations for WCFs represent the excess of revenues over expenses since the fund inception, transfers of assets in or out without reimbursement since the fund inception, less refunds to customers, and future funding requirements.

1.V. Treaties for Use of Foreign Bases

The DoD Components have the use of land, buildings, and other facilities which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State.

Generally, treaty terms allow the DoD Components continued use of these properties until the treaties expire. These fixed assets are subject to loss in the event treaties are not renewed or the DoD does not reach other agreements. Therefore, in the event treaties or other agreements are terminated and use of the foreign bases is no longer allowed, losses will be recorded for the value of any nonretrievable capital assets after negotiations between the United States and the host country determined the amount to be paid to the United States for such capital investments.

1.W. Comparative Data

In FY 2002, the Department modified the financial statement presentation for the Statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing. As a result, the Department's statements during this reporting period may not always lend themselves to comparative analysis. In some instances, amounts on the statements were reported on one financial line in FY 2001 and split into multiple financial lines for FY 2002, in accordance with OMB guidance.

1.X. Unexpended Obligations

The DLA records obligations for goods and services that have been ordered but not yet received. No liability for payment has been established in the financial statements because goods/services have yet to be delivered.

1.Y. Environmental Liabilities

DLA's environmental liabilities are generated by business activities that are funded by the DWCF. With the exception of the DWCF funds provided to the Defense Energy Support Center (DESC), the funding required to satisfy those environmental liabilities is made available through the general fund.

Material disclosures are provided in Note 11, *Environmental Liabilities*.

1.Z. Reclassifications

Certain amounts and balances from the prior year have been reclassified to conform to the presentation of the current year.

Note 2. Nonentity and Entity Assets

As of September 30, 2002 and 2001
(Amounts in thousands)

	2002			2001
	Nonentity	Entity	Total	
Intra-governmental Assets				
Fund Balance with Treasury	\$ -	\$ -	\$ -	\$ -
Accounts Receivable	-	832,212	832,212	692,660
Other Assets	-	244	244	240
Total Intragovernmental Assets	\$ -	\$ 832,456	\$ 832,456	\$ 692,900
Non-Federal Assets				
Cash and Other Monetary Assets	\$ 4,390	\$ -	\$ 4,390	\$ 5,429
Accounts Receivable	-	457,931	457,931	286,748
Inventory and Related Property	-	11,535,642	11,535,642	11,007,801
General Property, Plant and Equipment	-	1,303,793	1,303,793	1,216,122
Other Assets	-	224,735	224,735	230,175
Total Non-Federal Assets	\$ 4,390	\$ 13,522,101	\$ 13,526,491	\$ 2,746,275
Total Assets	\$ 4,390	\$ 14,354,557	\$ 14,358,947	\$ 13,439,175

Other Information:

Assets are categorized as either:

(1) Entity assets consist of resources that the DLA has the authority to use, or where management is legally obligated to use funds to meet entity obligations.

(2) Nonentity assets are assets held by an entity, but are not available for use in the operations of the entity.

Further Note Disclosures:

Note 5, *Other Assets*

Note 6, *Cash and Other Monetary Assets*

Note 3. Fund Balance with Treasury

Disbursements and Collections: Current year disbursements and collections per the Cash Management Report (CMR), cash transfers and apportionments are

transferred to the Other Defense Organizations-WCF component level. The breakout for each is annotated in the following table (amounts in thousands):

	Disbursements	Collections	Apportionment	Transfers	FBWT
Distribution Depots	\$ 1,495,715	\$ (1,373,366)	\$ (300)	\$ (122,049)	\$ -
Supply Management	18,377,684	(18,867,637)	(75,300)	565,253	-
DAPS	410,260	(401,870)	(100)	(8,290)	-
DRMS	312,422	(351,006)	-	38,584	-
Total	\$ 20,596,081	\$ (20,993,879)	\$ (75,700)	\$ 473,498	\$ -

Apportionments: The DLA WCF received a \$700,000 apportionment on Treasury Appropriation Warrant 529-97-4-1,

dated October 1, 2001, as a distribution of the "DoD Supplemental Appropriations Act of FY 2001."

In addition, the DLA WCF received \$75 million from a reprogramming action (FY02-59 IR) from the Defense Emergency Response Fund (DERF) in Public Law 107-

206 dated August 29, 2002. This reprogramming action was for DESC, which is a Supply Management activity.

Note 4. Accounts Receivable

As of September 30, 2002 and 2001

(Amounts in thousands)

	2002			2001
	Gross Amount Due	Allowance for Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
Intragovernmental Receivables	\$ 832,212	\$ N/A	\$ 832,212	\$ 692,660
Non-Federal Receivables (From the Public)	464,308	(6,377)	457,931	286,748
Total Accounts Receivable	\$ 1,296,520	\$ (6,377)	\$ 1,290,143	\$ 979,408

Allowance Method:

The allowance for uncollectible accounts is based upon analysis of collection experience by system.

Other Information:

Allocation of Undistributed Collections: The difference between collections that are reported on the Cash Management Report (CMR), cumulative from inception, and the entity general ledger is referred to as undistributed collections. DoD FMR Volume 6B, Chapter 4, requires that undistributed collections be offset against an entity's

Federal and Non-Federal accounts receivable balances. The analysis to support these undistributed balances was performed, but was limited to current year collections only, and thus undistributed balances from prior years could not be ascertained. The following table shows the amounts used to offset accounts receivable in each DLA activity group (amounts in thousands):

	A/R Per Activity Records	Undistributed Collections	Intra-Activity Eliminations	Intra-DLA Eliminations	Gross Amount Due	Net Amount Due Allowances
Distribution	\$ 204,701	\$ (408)	\$ -	\$ (73,415)	\$ 30,878	\$ (9)
Supply Management	1,225,248	(28,843)	(25,571)	(100,186)	1,070,648	(4,188)
DAPS	77,115	12,075	(62)	(7,387)	81,741	(137)
DRMS	16,133	(137)	(252)	(2,491)	3,253	(2,043)
Total	\$ 1,523,197	\$ (17,313)	\$ (25,885)	\$ (183,479)	\$ 1,296,520	\$ (6,377)

Elimination Adjustments: DLA's non-stockfund systems capture trading partner data at a transaction level in a manner that facilitates trading partner aggregations. However, DLA's stockfund systems do not capture trading partner data at a transaction level in a manner that facilitates trading partner aggregations. Allocation of non-

interfund intragovernmental trading partner data is based on the percentage of funds recorded at the appropriation level for interfund reimbursement transactions posted on DLA's general ledgers. By design, the interfund system provides appropriations from which DLA's customers pay for the materiel bought from its inventories. The DoD

intends to develop long-term systems improvements that will include sufficient upfront edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished with the existing or foreseeable resources. The transaction source data is the sum of WCF reimbursable issues billed and collected through the interfund system for the period. Entity or buyer information is derived from allocations based on percentage of specific transaction activity as compared to the total activity except where the entity data can be derived directly from the general ledger accounts.

In FY 2002, the estimated amount of Foreign Military Sales (FMS) funds that were transferred from intra-governmental to non-Federal to be \$87.2 million in accounts receivable and \$636.6 million in revenue.

Accounts Receivable Over 180 Days Old: DLA's non-stockfund has \$27.3 million of intragovernmental and non-Federal receivables over 180 days old. Due to the fact that DLA stockfund systems only age receivables over 120 days, we have reported Supply-Materiel accounts receivable of \$293.8 million over 120 days old. The distributions between DLA activity groups are as follows (amounts in thousands):

	2002	2001
Distribution Depots	\$ 25	\$ 47
Supply - Operations	1,692	27,298
DAPS	21,147	73,462
DRMS	<u>6,908</u>	<u>33,497</u>
Total (Over 180 Days)	\$ 29,298	\$ 134,304
Supply Materiel (Over 120 Days)	\$ 293,766	\$ 190,549

Note 5. Other Assets

As of September 30, 2002 and 2001
(Amounts in thousands)

	2002	2001
Intragovernmental Other Assets		
Advances and Prepayments	\$ 244	\$ 240
Non-Federal Other Assets		
Other Assets (With Public)	<u>\$ 224,735</u>	<u>\$ 230,175</u>
Total Other Assets	<u>\$ 224,979</u>	<u>\$ 230,415</u>

Other Information:

Intragovernmental Other Assets: Represents \$5,000 in advances reported by Distribution Depots in FY 2002 and \$239,000 that was recorded as a result of the elimination process (Advances to Others).

Non-Federal Other Assets: Represents \$1.3 million in travel advances, \$223.4 million in progress payments made to contractors, and \$44,000 in advances to contractors and suppliers.

In FY 2001, bid deposits in the amount of \$5.4 million were recorded as Other Assets - Public. This bid deposit amount was reclassified to conform to the FY 2002 presentation as Cash and Other Monetary Assets (*see Note 6, Cash and Other Monetary Assets*).

Note 6. Cash and Other Monetary Assets

In accordance with DoD FMR Volume 11A, Chapter 5, bid deposits should be recorded in suspense account X6501. The collections are received and accounted for in a suspense account. At the time the appropriate bid selection

is made, these funds are returned to the bidder(s). The \$4.4 million in Cash represents bid collections received by DRMS still remaining in suspense as of September 30, 2002.

Note 7. Inventory and Related Property

As of September 30, 2002 and 2001
(Amounts in thousands)

	2002	2001
Inventory, Net (Note 7.A.)	\$11,525,134	\$10,994,224
Operating Materials and Supplies, Net (Note 7.B.)	<u>10,508</u>	<u>13,577</u>
Total	<u>\$11,535,642</u>	<u>\$11,007,801</u>

Note 7.A. Inventory, Net

As of September 30, 2002 and 2001
(Amounts in thousands)

	2002		2001		
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Inventory, Net	Valuation Method
Inventories Categories:					
Available and Purchased for Resale	\$ 11,919,059	\$ (404,947)	\$ 11,514,112	\$ 10,830,468	LAC/MAC
Held for Repair	11,410	(388)	11,022	12,731	LAC
Excess, Obsolete, and Unserviceable	<u>3,584,588</u>	<u>(3,584,588)</u>	<u>-</u>	<u>151,025</u>	<u>NRV</u>
Total	<u>\$ 15,515,057</u>	<u>\$ (3,989,923)</u>	<u>\$ 11,525,134</u>	<u>\$ 10,994,224</u>	

Legend for Valuation Methods

LAC = Latest Acquisition Cost, adjusted for holding gains and losses

MAC = Moving Average Cost

NRV = Net Realizable Value

Restrictions of Inventory Use, Sale, or Disposition:

There are no restrictions on the use, sale, or disposition of inventory except in the following situations:

- Distributions without reimbursement are made when authorized by DoD directives.

- Inventory, with the exception of safety stocks, may be sold to foreign, state and local governments, private parties, and contractors in accordance with current policies and guidance or at the direction of the President.

Other Information:

General Composition of Inventory

Inventory includes spare and repair parts, clothing and textiles, fuels, and ammunition. Inventory is tangible personal property that is:

1. Held for sale, or held for repair for eventual sale;
2. In the process of production for sale; or
3. To be consumed in the production of goods for sale or in the provision of services for a fee.

Inventory Categories

- (1) Available and Purchased for Resale - This category of inventory includes most supply system materiel in condition to be issued. This category also includes in-transit inventory from commercial and government suppliers. General ledger accounts are used to record the initial acceptance of inventory items when title has passed but the items have not been received and accepted into inventory.
- (2) Inventory Held for Repair – These are inventory items that are not in a condition to be issued (but not beyond economical repair) and are awaiting repair before they are eligible for sale.
- (3) Excess, Obsolete, and Unserviceable – Per new DoD policy implemented in FY 2002, only condemned materiel classified in condition codes H, P, S, and V is accounted for as “Excess, Obsolete, and Unserviceable.” Potentially redistributable materiel, presented in previous years as “Excess, Obsolete and Unserviceable” is included in the “Available and Purchased for Resale” or “Held for Repair” categories according to its condition.

Inventory Valuation

In a July 6, 2001 memo, the Office of the Under Secretary of Defense (OUSD) prescribed moving average cost as the inventory valuation method to provide the best value to the Department based on the Components’ analyses of the

Department’s materiel management policies and processes. The memo also noted that DoD legacy systems, including DLA’s, were not designed to maintain historical cost valuation for inventory held for sale and operating materiel and supplies in compliance with GAAP. Therefore, alternative valuation methods were authorized for continued use for other functional requirements (e.g., logistics, procurement and budget) as deemed necessary. The alternative valuation methods authorized include LAC and standard price.

DLA launched a new system, Business Systems Modernization (BSM) in August 2002, which incorporates the moving average cost method. The remainder of the inventory items reported on the financial statements is derived from legacy logistics systems designed for materiel management rather than accounting. These systems do not maintain the historical cost data necessary to comply with the SFFAS No. 3, Accounting for Inventory and Related Property.

Inventories in these legacy systems are valued at latest acquisition cost and approximate historical cost. The LAC method applies the last representative invoice price to all like units held, including units acquired through donation, non-monetary exchange, and returns from end use or reutilization. Generally, LAC is determined by subtracting the appropriate surcharges from the standard cost to arrive at the price most recently paid for a carried item. In prior years (FY 1992- 1996), gains or losses that resulted from valuation changes for inventory items were immediately recognized and reported in the operating results in the Statement of Net Cost as a cost of goods sold. However, the use of LAC requires these amounts be recognized only upon the sale or disposal of materiel, rather than as the price variance occurs. Therefore, an allowance account was established on the financial statements to display unrealized holding period gains and losses. This allowance account is not under general ledger control of the individual commodities, but is calculated and compiled on a spreadsheet application approved by the OUSD(C) and DFAS-Arlington. The purpose of the allowance account is to provide a representation of inventory at historical cost.

The total Gross Value of “Available and Purchased for Resale” amount of \$11.9 billion is composed of BSM and Legacy elements as follows:

<u>Element</u>	<u>Amount</u>	<u>Valuation Method</u>
BSM	\$ 198,763	Moving Average Cost
Legacy	<u>11,720,296</u>	Adjusted LAC
Total (in thousands)	<u>\$11,919,059</u>	

The entire Gross Value amount of \$11.4 million in “Held for Repair” is from the Legacy system.

The Gross Value in the “Excess, Obsolete, and Unserviceable” account consists of amounts from Supply Management (\$117,000) and DRMS (\$3.6 billion).

Excess, Obsolete, and Unserviceable Inventory Valuation
As noted above, the DoD has implemented a change in

policy with regard to accounting for “Excess, Obsolete, and Unserviceable” that is effective for FY 2002. In the past, through its stratification process and using values from the Supply System Inventory Report (SSIR), DLA identified that approximately \$1.4 billion of their Supply Management inventory met the DoD definition of potential excess and was written down to net realizable value (NRV). The remaining portion was expensed and included in the calculation of unrealized holding period gains and losses.

The DRMS inventory valuation was also changed by the new DoD policy. The previous procedure was to adjust the acquisition value of the material transferred to DRMS by a percentage factor to yield an NRV. Effective for FY 2002, DRMS was directed to write down the value of incoming disposal inventory to an NRV of zero.

In the previous year’s financial statements, the DRMS NRV inventory amount was erroneously used as the gross value, and no revaluation was applied against it.

Note 7.B. Operating Materials and Supplies, Net

DLA’s Operating Materials and Supplies (OM&S) are classified as “Held for Use.” In FY 2002, the OM&S gross value was \$10.5 million as compared to the FY 2001 value of \$13.6 million.

Restrictions on OM&S:

There are currently no restrictions on the use, sale, or disposition of operating materials and supplies.

Other Information:

DAPS OM&S is composed primarily of paper, toner, and CD-ROM disks. These materials and supplies are consumed in the production of end products for the DAPS customers, and continued improvements to the automated production of electronic documents are produced via CD-ROM disks.

OM&S data reported on the financial statements is derived from logistics systems designed for materiel management purposes. These systems do not maintain the historical cost data necessary to comply with the SFFAS No. 3, Accounting for Inventory and Related Property. In addition, while these logistics systems provide management information on the accountability and visibility over OM&S items, the timeliness at which this information is provided creates issues regarding the completeness and existence of the OM&S quantities used to derive the values reported on the financial statements.

DLA uses the purchase method of accounting for OM&S in situations where it is more cost beneficial than the consumption method. Current financial and logistic systems do not fully support the consumption method. Therefore, significant portions of DLA’s OM&S were reported under the purchase method for FY 2002.

Note 8. General Property, Plant and Equipment, Net

As of September 30, 2002 and 2001
(Amounts in thousands)

					2002	2001
	Depreciation / Amortization Method	Service Life	Acquisition Value	Accumulated Depreciation/ Amortization	Net Book Value	Prior FY Net Book Value
Major Asset Classes						
Land	N/A	N/A	\$-	\$N/A	\$-	\$954
Buildings, Structures, and Facilities	S/L	20 Or 40	1,784,432	(1,112,793)	671,639	576,332
Software	S/L	2-5 Or 10	344,618	(217,325)	127,293	53,158
Equipment	S/L	5 Or 10	577,734	(359,070)	218,664	281,859
Construction-in-Progress	N/A	N/A	286,197	N/A	286,197	303,819
Total General PP&E			<u>\$ 2,992,981</u>	<u>\$ (1,689,88)</u>	<u>\$ 1,303,793</u>	<u>\$ 1,216,122</u>

Depreciation Method: S/L = Straight Line

Other Information:

Real Property in the Hands of Contractors: The value of DLA real property in the possession of contractors is included in the values reported above for the major classes of Buildings, Structures, and Facilities. The value of personal property (Major Classes of Software and Equipment) in the possession of contractors is not included in the values reported above. The DoD presently is reviewing its process for reporting these amounts in an effort to determine the best method to annually collect this information.

Reconciliation of General Ledger and Property System Balances: The balances reported in FY 2002 were not fully reconciled. Efforts to ensure that the PP&E values presented on the trial balance are accurate and complete will be performed in accordance with departmental guidance. These efforts include a validation of assets and a reconciliation of the property system to the general ledger.

The PP&E - Other amount of \$195.7 million reported in the FY 2001 financial statements has been reclassified as PP&E - Equipment for FY 2002.

Note 9. Liabilities Not Covered and Covered by Budgetary Resources

As of September 30, 2002 and 2001
(Amounts in thousands)

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	Total	
Intragovernmental Liabilities				
Accounts Payable	\$ 142,959	\$ -	\$ 142,959	\$ 100,849
Other	7,948	39,941	47,889	53,781
Total Intragovernmental Liabilities	\$ 150,907	\$ 39,941	\$ 190,848	\$ 154,630
Non-Federal Liabilities				
Accounts Payable	\$ 1,648,381	\$ -	\$ 1,648,381	\$ 1,865,469
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	-	199,990	199,990	245,648
Other Liabilities	196,835	101,317	298,152	306,108
Total Non-Federal Liabilities	\$ 1,845,216	\$ 301,307	\$ 2,146,523	\$ 2,417,225
Total Liabilities	\$ 1,996,123	\$ 341,248	\$ 2,337,371	\$ 2,571,855

Other Information:

Amount (in thousands)

Liabilities Not Covered by Budgetary Resources are those liabilities, which are not considered covered by realized budgetary resources as of the balance sheet date.

Liabilities Covered by Budgetary Resources are those that are incurred by the reporting entity that are covered by realized budget resources as of the balance sheet date. Budgetary Resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year. Available budgetary resources include: (1) new budget authority, (2) spending authority from offsetting collections (credited to an appropriation or fund account), (3) recoveries of unexpired budget authority through downward adjustments of prior year obligations, (4) unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and (5) permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet dated, provided that the resources may be apportioned by the OMB without further action by the Congress or without a contingency first having to be met.

Intragovernmental Other Liabilities

Covered by *Budgetary Resources*

Accrued Employee Benefits	\$ 7,605
Prior Year Workers Compensation	343

Not Covered by *Budgetary Resources*

Unfunded FECA Liability	39,800
Judgment Fund	141

Total Intragovernmental Other Liabilities \$ 47,889

Non-federal Other Liabilities

Covered by *Budgetary Resources*

Advance Payments Held in Reserve for Future Orders from Civilian Agencies	\$ 139,194
Accrued Funded Payroll and Leave	24,982
Unearned Revenue	28,269
Bid Deposits	4,390

Not Covered by *Budgetary Resources*

Accrued Unfunded Annual Leave	101,317
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Total Non-federal Other Liabilities \$ 298,152

The \$139.2 million in Non-Federal Other Liabilities, covered by Budgetary Resources represents Advances From Others, which consists of Reserve Equity for Others. This account contains reserves or deposits made by civilian agencies or military services in support of Cooperative Logistics Support adjustments.

Further Note Disclosures:

Note 10, *Accounts Payable*

Note 12, *Other Liabilities*

Note 14, *Military Retirement Benefits and Other Employment Related Actuarial Liabilities*

Note 10. Accounts Payable

As of September 30, 2002 and 2001
(Amounts in thousands)

	2002			2001
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
Intragovernmental Payables	\$ 142,959	\$ N/A	\$ 142,959	\$ 100,849
Non-Federal Payables (to the Public):	<u>1,648,381</u>	<u>-</u>	<u>1,648,381</u>	<u>1,865,469</u>
Total	<u>\$ 1,791,340</u>	<u>\$ -</u>	<u>\$ 1,791,340</u>	<u>\$ 1,966,318</u>

Other information:

Intragovernmental Eliminations: The DLA systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the intragovernmental accounts payable balances could not be reconciled with its trading partners. DLA's intragovernmental accounts payable was in excess of the accounts receivable reported by the seller. Per DoD FMR Volume 6B, Chapter 13, DLA's intragovernmental accounts payable totals were adjusted to agree with the seller-side accounts receivable data. The differences are reclassified as Non-Federal accounts payable. The amount of this reclassification from intragovernmental to non-Federal was \$172 million. The DoD intends to develop long-term systems improvements that will include sufficient upfront edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliations cannot be accomplished with the existing or foreseeable resources.

Undistributed Disbursements: Undistributed disbursements are the difference between disbursements

recorded at the detailed level to a specific obligation, payable, or receivable in the activity field records versus those reported by the U.S. Treasury via the reconciled DD 1329 and DD 1400. This should agree with the undistributed reported on accounting reports (SF133/ (M) 1002/ (M) 1307. In-transit payments are payments that have been made for other agencies or entities that have not been recorded in their accounting records. These payments are applied to the entities outstanding accounts payable balance at year-end. Accounts payable were adjusted downward in the amount reported on the CMR (cumulative from inception), and the entity general ledger is referred to as undistributed disbursements. DoD policy requires that undistributed disbursements offset the entity's Federal and non-Federal accounts payable balance. The analysis to support these undistributed balances was performed but was limited to current year disbursements only, and thus undistributed balances from prior years could not be ascertained. Undistributed balances were prorated between Federal and non-Federal accounts payable based on the payable percentages. The following table shows the amounts used to offset accounts payables in each DLA activity group (amounts in thousands):

	A/P Per Activity Records	Undistributed Disbursements	Intra-Activity Eliminations	Intra-DLA Eliminations	Net A/P
Distribution Depots	\$ 169,241	\$ (42,719)	\$ -	\$ (79,510)	\$ 47,012
Supply Management	1,854,425	(245,775)	(25,570)	(102,296)	1,480,784
DAPS	106,850	24,286	(62)	(304)	130,770
DRMS	<u>133,848</u>	<u>546</u>	<u>(251)</u>	<u>(1,369)</u>	<u>132,774</u>
Total DLA Payables	<u>\$ 2,264,364</u>	<u>\$ (263,662)</u>	<u>\$ (25,883)</u>	<u>\$ (183,479)</u>	<u>\$ 1,791,340</u>

Note 11. Environmental Liabilities

The books of the Defense Energy Support Center (DESC), a component of the DLA DWCF, do not record a reserve for environmental liability. Despite the fact that a potential liability exists in the approximate amount of \$35.2 million, the proper accounting treatment of this amount is currently under discussion between the Defense Finance and Accounting Service and DESC. We expect upcoming discussions will produce a viable solution to the accounting treatment of this potential liability.

DLA recorded \$169.5 million for environmental cleanup costs funded through the Defense Environmental Restoration Program (DERP) and Base Realignment and Closure (BRAC) in FY 2002. This liability, although generated by WCF operations and activities, is recorded on the DLA General Fund financial statements, since they administer the DERP and BRAC environmental cleanup programs.

Note 12. Other Liabilities

As of September 30, 2002 and 2001

(Amounts in thousands)

	2002			2001
	Current Liability	Noncurrent Liability	Total	Total
Intragovernmental				
Judgment Fund Liabilities	\$ 141	\$ -	\$ 141	\$ 2,284
FECA Reimbursement to the Department of Labor	8,218	31,582	39,800	45,872
Other Liabilities	<u>7,948</u>	<u>-</u>	<u>7,948</u>	<u>5,625</u>
Total Intragovernmental Other Liabilities	<u>\$ 16,307</u>	<u>\$ 31,582</u>	<u>\$ 47,889</u>	<u>\$ 53,781</u>
Non-Federal				
Accrued Funded Payroll and Benefits	\$ 24,982	\$ -	\$ 24,982	\$ 25,288
Advances from Others	167,463	-	167,463	181,457
Deposit Funds and Suspense Accounts	4,390	-	4,390	5,429
Accrued Unfunded Annual Leave	<u>101,317</u>	<u>-</u>	<u>101,317</u>	<u>93,934</u>
Total Non-Federal Other Liabilities	<u>\$ 298,152</u>	<u>\$ -</u>	<u>\$ 298,152</u>	<u>\$ 306,108</u>
Total Other Liabilities	<u>\$ 314,459</u>	<u>\$ 31,582</u>	<u>\$ 346,041</u>	<u>\$ 359,889</u>

Other Information:

Intragovernmental

Advances from Others: The FY 2001 amount of \$134.3 million was reclassified from intragovernmental to non-Federal for FY 2002.

Judgment Fund: DLA reconciled the information provided by Treasury to determine outstanding reimbursements owed the Judgment Fund. As a result, \$141,000 was identified as the valid reimbursement to Treasury by DLA. Reimbursement to the Judgment Fund will be made in FY 2003 (see Note 15.B, *Imputed Expenses*).

FECA Reimbursement to the Department of Labor (DoL): FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to either condition. FECA claims are submitted to and approved by the DoL. DoL pays the claim holders and prepares a chargeback to the applicable agency. The liability represents the chargeback amount to the applicable agency. Public Law 93-416, Section 8147 essentially gives agencies two years to pay the chargeback bill, allowing time for inclusion in their budgets. Therefore, there should be an unfunded liability in the annual financial statements for these two years, plus an accrual for the 4th quarter of the current fiscal year. In the current year, a weighted average method was established to allocate the FECA liability. It must be noted that this change in policy has no material impact on the FECA liability balance, in comparison to previous years. Any

fluctuation in entity balances is solely based upon a true variance in the account (see Note 14, *Military Retirement Benefits and Other Employment Related Actuarial Liabilities*).

Other Intragovernmental Liabilities, Other Liabilities:

(amounts in thousands)

	FY 2002	FY 2001
Accrued Employee Benefits	\$ 7,605	\$ 5,625
Prior Year Workers Compensation	343	-
Total	\$ 7,948	\$ 5,625

Intragovernmental Reconciliations for Fiduciary

Transactions with the DoL and the OPM: With respect to the major fiduciary balances with the OPM and the DoL, the DFAS was able to reconcile with the OPM and the DoL. No material differences were identified during the reconciliation.

Non-Federal

Advances from Others: A total of \$139.2 million is related to advance payments being held in reserve for future orders from civilian agencies for Supply Management Materiel. The remaining \$28.3 million is attributed to DRMS Unearned Revenue.

Deposit Funds and Suspense Accounts: The total amount of \$4.4 million represents DRMS bid collections. (See Note 6, *Cash and Other Monetary Assets*.)

Other Disclosures

DLA recorded \$5.3 million for unemployment benefits funded through the General Fund. A portion of that cost is applicable to the DLA WCF.

Note 13. Commitments and Contingencies

The DLA is currently reviewing claims and is involved in suits before the U.S. Court of Federal Claims regarding the use of economic price adjustments clauses in fuels contracts awarded from 1982 through 1999. DLA believes that the basis of the claims and suits is unjustified

and that use of the clauses was proper and in accordance with law. The value of claims and cases is approximately \$2.6 billion. DLA is not recognizing these as contingent legal liabilities in the financial statements.

Note 14. Military Retirement Benefits and Other Employment-Related Actuarial Liabilities

The DLA's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DLA at the end of each fiscal year. The liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using a method that utilizes historical benefit payment patterns to predict the ultimate payments. The projected annual

benefit payments are then discounted to the present value using the OMB's economic assumptions for 10-year U.S. Treasury notes and bonds. Cost of living adjustments and medical inflation factors are also applied to the calculation of projected future benefits. For FY 2002, the unfunded actuarial liability amount for FECA decreased to \$200 million in comparison to the amount recorded in FY 2001 of \$246 million.

Note 15.A. General Disclosures Related to the Statement of Net Cost

While the DLA's WCFs generally record transactions on an accrual basis as is required by Federal GAAP, the systems do not always capture actual costs. Information

presented on the Statement of Net Cost is primarily based on budgetary obligation, disbursements, or collection transaction, as well as information from nonfinancial feeder systems.

Note 15.B. Imputed Expenses

As of September 30, 2002 and 2001 (Amounts in thousands)	2002	2001
Civilian (e.g., CSRS/FERS) Retirement	\$49,258	\$49,851
Civilian Health	68,930	72,483
Civilian Life Insurance	212	205
Judgment Fund	<u>2,520</u>	<u>-</u>
Total Imputed Expenses	<u>\$ 120,920</u>	<u>\$ 122,539</u>

Further Note Disclosure

Note 16, *Disclosures Related to the Statement of Changes in Net Position*

Note 15.C. Exchange Revenue

Supply Management: Each catalogued item with a national stock number assigned which is managed by a DoD Inventory Control Point has a standard price for sales to all authorized customers, except as may be authorized. Components establish product prices at the lowest practical item level in order to promote cost visibility/management and to motivate cost effective supplier behavior. At a minimum, prices are established by Federal Supply Class

(FSC) or other comparable level at which specific cost allocations can be made. Product pricing levels above the FSC are approved by the OUSD (C). The standard sales price becomes effective for billing purposes on the first day of the fiscal year.

Distribution: Consistent with activity- based costing techniques, DLA implemented the Net Landed Cost

pricing mechanism at the Distribution Depots in FY 2002. The Net Landed Cost pricing structure provides our customers with greater visibility of their distribution costs by commodity, customer, and transactions in order for them to make more informed supply decisions.

Defense Reutilization and Marketing Service: DRMS recovers operating costs with a combination of proceeds from the (1) sale of surplus personal property to the public, (2) reimbursements from specific customers for work performed, and (3) a Service Level billing paid by the Military Services and Supply Management Activity Groups. DLA developed Transaction Activity Billing to

recover mission costs through a process that provides customers (Military Services and DLA) bills based on services and workload for property disposition.

Document Automation and Production Service: Sales prices are published in the DAPS Production Standards and Pricing Manual by revenue process. A revenue process is a discrete process or activity in electronic conversion, retrieval, output and distribution of digital and hard copy information. Prices are set at a level to recover cost and accumulated operating result. Customer price change is approved by the OUSD (C). The sales price becomes effective for billing on the first day of the fiscal year.

Note 15.D. Intragovernmental Revenue and Expense

Activity	Revenue	Expense
Distribution	\$ 633,263	\$ 165,606
Supply Management	282,557	776,231
DAPS	17,515	5,557
DRMS	54,531	40,472
Total	<u>\$ 987,866</u>	<u>\$ 987,866</u>

Intragovernmental Eliminations: The DLA systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, the intragovernmental operating expense balances could not be reconciled with its trading partners. DLA's intragovernmental expenses were short of the revenue reported by the seller. Per DoD FMR Volume 6B,

Chapter 13, DLA's intragovernmental expenses were adjusted to agree with the seller-side revenue data. The amount of the reclassification from public expense to Federal expense was \$572.8 million in FY 2002. The break out of Intra-DLA revenue/expense eliminations as stated on the Statement of Net Cost is by activity group (amounts in thousands).

Note 16. Disclosures Related to the Statement of Changes in Net Position

As of September 30, 2002 and 2001
(Amounts in thousands)

	Cumulative Results of Operations 2002	Cumulative Results of Operations 2001
Imputed Financing		
Civilian CSRS/FERS		
Retirement	\$49,258	\$49,851
Civilian Health	68,930	72,483
Civilian Life Insurance	212	205
Judgment Fund	2,520	-
Total Imputed Financing	<u>\$ 120,920</u>	<u>\$ 122,539</u>

Other Information:**Imputed Financing**

The amounts the DLA remits to OPM for employees covered by the CSRS, FERS, FEHB and FEGLI do not fully cover the Government's cost to provide these benefits. An imputed cost is recognized as the difference between the Government's cost of providing these benefits to the employee contributions made by and for them by DFAS. The imputed financing cost factors are provided by the OPM to the Office of the Under Secretary of Defense (Personnel and Readiness) (OUSD(P&R)) and DLA. DFAS provides civilian employees base salary and number of employees electing health benefits by reporting entity to the OUSD(P&R). The OUSD(P&R) computes and validates the imputed expenses for civilian employees' retirement and other benefits and provides it to the reporting components.

Other Disclosures

(1) Cumulative Results of Operations, Other Financing Sources, Transfers-in/out Without Reimbursement totals \$542.3 million. The following tables detail the transfers-in/out by business unit:

(2) Cumulative Results of Operations, Budgetary Financing Sources, Other Budgetary Financing Sources: The total of \$4.6 million in other budgetary financing sources is a benefit derived from assets constructed with MILCON dollars.

Further Note Disclosures:

Note 3, *Fund Balance with Treasury*

Note 15, *Disclosures Related to the Statement of Net Cost*

Distribution Depots

Financing Sources Transferred In without Reimbursement	\$ 198,078
Financing Sources Transferred Out without Reimbursement	(68,784)
Cash Transfer to Component Level	122,349
Supplemental Appropriation Transfer	(300)
Total (in thousands)	\$ 251,343

DAPS

Cash Transfer to Component Level	\$ 8,390
Supplemental Appropriation Transfer	(100)
Total (in thousands)	\$ 8,290

DRMS

Cash Transfer to Component Level	\$ (38,584)
Financing Sources Transferred In without Reimbursement	7,920
Financing Sources Transferred Out without Reimbursement	(127,915)
Total (in thousands)	\$ (158,579)

Supply Management

Financing Sources Transferred In without Reimbursement	\$ 473,173
Reclass to Other Gains (TB eliminations)	(171,639)
Financing Sources Transferred Out without Reimbursement	(379,633)
Cash Transfer to Component Level	(489,953)
Supplemental Appropriation Transfer	(75,300)
Total (in thousands)	\$ (643,352)

Note 17.A. Disclosures Related to the Statement of Budgetary Resources

As of September 30, 2002 and 2001 (Amounts in thousands)	2002	2001
Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$8,538,069	\$7,343,834
Available Borrowing and Contract Authority at End of the Period	\$8,279,157	\$7,984,004

Other Information:

Undelivered Orders at the End of the Period

The Net Amount of Budgetary Resources Obligated for

Undelivered Orders at the End of the Period consists of the items shown in the table below (amounts in thousands):

	Undelivered Orders, Unpaid	Undelivered Orders, Prepaid	Adjustment of Prior-Year Unpaid Undelivered Orders	Total
Distribution	\$ 231,709	\$ (462)	\$ -	\$ 231,247
Supply Management	8,002,618	224,793	(30)	8,227,381
DAPS	39,307	99	-	39,406
DRMS	39,995	40	-	40,035
Total	\$ 8,313,629	\$ 224,470	\$ (30)	\$ 8,538,069

Available Borrowing and Contract Authority at the End of the Period

The amount of Borrowing and Contract Authority represents the funds available since the inception of the DLA's WCF. The FY 2002 cumulative contract authority for DLA does not agree with the 2108; this difference is currently under review.

Apportionment Categories

All of the DLA's reimbursable obligations are apportioned under category A, which are apportionments on a fiscal quarterly basis. Spending Authority from Offsetting Collections - Adjustments in funds that are permanently

not available (included in the "Adjustment" line on the Statement of Budgetary Resources), are not included in the "Spending Authority From Offsetting Collections and Adjustments" line on the Statement of Financing.

Other DLA Disclosures

The DLA received a capital infusion in the total amount of about \$75.7 million. See Note 3, Fund Balance with Treasury.

Further Note Disclosure:

Note 15, *Disclosure Related to the Statement of Net Cost*

Note 17.B. Disclosures Related to Problem Disbursements, In-Transit Disbursements and Suspense/Budget Clearing Accounts

As of September 30, 2002 and 2001 (Amounts in thousands)	2002	2001	(Decrease)/Increase
Total Problem Disbursements			
Absolute Unmatched Disbursements	\$ 24	\$ 20	\$ 4
Negative Unliquidated Obligations	-	2	(2)
Total In-transit Disbursements, Net	\$ 5	\$ 8	\$ (3)

Absolute value is the sum of the positive values of debit and credit transactions without regard to the sign.

Unmatched Disbursements (UMDs) occur when payments do not match to a corresponding obligation in the accounting system.

Negative Unliquidated Obligations (NULOs) occur when payments have a valid obligation but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments use available funds for valid receiving reports on delivered goods and services under valid contracts.

In-Transits represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity but not yet posted in an accounting system.

The DLA has \$24,000 in problem disbursements and \$5,000 in in-transit disbursements that represent disbursements of DLA funds that have been reported by a disbursing station to the Department of the Treasury but have not yet been precisely matched against the specific source obligation giving rise to the disbursements. For the most part, these payments have been made using available funds and based on valid receiving reports for goods and services delivered under valid contracts. The problem disbursements and in-transit disbursements arise when the DLA's various contracting, disbursing, and accounting systems fail to match the data necessary to properly account for the disbursement transactions in all applicable accounting systems. The DLA has efforts underway to improve the systems and to resolve all previous problem disbursements and process all in-transit disbursements.

Note 18. Disclosures Related to the Statement of Financing

Resources That Do Not Finance Net Cost of Operations:

(1) Resources that fund expenses recognized in prior periods

Activity	Change in Unfunded Annual Leave	FECA Liab/Exp for FY 2002	Current Year Actuarial FECA Liab/Exp for FY 2002	Change in Judgment Fund Liability	Total (in thousands)
Distribution Depots	(\$551)	(\$1,756)	(\$13,202)	\$ -	(\$15,509)
Supply Mgt. Ops.	-	(3,622)	(27,239)	(1,570)	(32,431)
DAPS	-	(292)	(2,198)	-	(2,490)
DRMS	(79)	(401)	(3,019)	(574)	(4,073)
Total (in thousands)	(\$ 630)	(\$ 6,071)	(\$ 45,658)	(\$2,144)	(\$54,503)

(2) Other resources or adjustments to net obligated resources that do not affect net cost of operations

DRMS – There was a decrease of \$39,000 in Travel Advances, an increase in Refund Receivables by \$14,000 and an increase in bad debt not covered by allowance for \$1,000.

Components of Net Cost of Operations that will not Require or Generate Resources - Other:

Supply Management Operations – There was a \$345,000 change in Allowance for Loss on Receivables, an adjustment of (\$836,000) for expenses recognized in prior year for proprietary purposes, and a \$26.5 million write off for assets booked in 1999 but never actually part of DLA.

DAPS – There was a \$137,000 change in Allowance for Loss on Receivables and a decrease of \$6,000 related to other events.

DRMS - There was a \$2 million change in Allowance for Loss on Receivables.

Other DLA Disclosures:

The statement of financing was expanded to further articulate and detail the relationship between net obligations from budgetary accounting and net cost of operation from proprietary accounting. Some items that were reported last year as a single line item were subdivided to reflect its components. Several new line items were added to separately identify and further explain the use of resources to finance net obligations or net cost of operations. This change notes key differences between the net obligations and net cost of operations.

Budgetary data is not in agreement with Proprietary Expenses and Assets Capitalized. This causes a difference in net cost between the Statement of Net Cost and the Statement of Financing.

Note 19. Restatement of FY 2001 Financial Statements

Account	As Previously Reported	As Restated
Inventory and Related Property	\$9,607,044	\$11,007,801
Cumulative Results of Operations	\$9,466,563	\$10,867,320

Subsequent to the issuance of the FY 2001 financial statements, the DoD implemented a change in policy with regard to accounting for “Excess, Obsolete, and Unserviceable” inventory, as discussed in Note 7.A. As a result, the calculation of the DLA Supply Management inventory balance contained a material error. The error relates to FY 2001 and prior periods. In accordance with

SFFAS No. 21, which requires that reporting entities restate period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of the error would be material to the financial statements in either period, the accompanying FY 2001 financial statements have been restated to reflect the correction of the calculation error.

**Required Supplementary
Stewardship Information**

**FOR THE YEARS ENDED
SEPTEMBER 30, 2002 AND 2001**

Defense Working Capital Fund

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HERITAGE ASSETS
FOR THE YEAR ENDED SEPTEMBER 30, 2002

	Measurement Quantity	As of 09/30/01	Additions	As of 9/30/02
Cemeteries & Archeological Sites	Sites		1	1
Buildings & Structures	Each	1	1	2

Executive Order 11593 from the United States Department of the Interior, Heritage Conservation and Recreation Service entered Bellwood, Chesterfield County, Virginia in the National Register. Operated by the Defense Supply Center - Richmond (DSCR), the Bellwood home is an early nineteenth century plantation house highlighted by slender columns extending up two stories, it also serves as the DSCR Officer's Club.

The DSCR Officer's Club is in good repair. There are no deferred maintenance projects for this facility. Currently, only preventive maintenance/service calls are being performed. The Department of Historical Resources in Richmond ensures the historical integrity of the property by approving any repairs, major or minor. The Office of Installation Services at DSCR provides most maintenance.

Building 280, Marine Barracks, Pearl Harbor, Hawaii is a World War II wooden barracks identified as a historic asset. This building is occupied by personnel from the Defense Supply Center – Philadelphia – Pacific as a tenant with the financial responsibility for sustainment. The occupied portion of the building has been renovated and is in good repair.

During the construction of a child development center at the Defense Supply Center – Richmond (DSCR), African American remains were unearthed, evaluated by commonwealth archeologists and subsequently re-interred in a newly established cemetery.

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Required Supplementary Information

FOR THE YEARS ENDED SEPTEMBER 30, 2002 AND 2001

Defense Working Capital Fund

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Real Property Deferred Maintenance
As of September 30, 2002
(\$ In Thousands)

(\$ in Thousands)

Property Type	Restoration as of 9/30/01	FY 2002			Restoration as of 9/30/02
		Annual Sustainment			
		Required	Actual	Difference	
Buildings and Structures	\$ -	\$493,538	\$218,424	\$275,114	\$ -
Annual Deferred Sustainment Trend					
Property Type		FY 2001		FY 2002	
Buildings and Structures		\$222,400		\$218,424	

The total deferred real property maintenance was calculated as the difference between actual FY 2002 real property sustainment as reported in DBMS, \$218.4 million, and the required FY 2002 real property sustainment from the DoD Facility Sustainment Model (FSM), \$493.5 million. The sustainment value was calculated by deflating the values derived from the FSM version 4.0 for DLA's FY 2004 sustainment, \$509.5 million, by 1.6 percent per year back to FY 2002 [\$509,458,218/(1.016*1.016)].

The DoD FSM uses a standard commercial per-square-foot cost factor (for each type of facility) that represents the cost to maintain a facility in good condition. The total Agency sustainment value is calculated by multiplying the total size of each type of facility at a given location by the commercial cost factor. The standard DoD geographic area cost factor for that location then adjusts all the facility costs for a given location.

Comprehensive real property condition information is unavailable as the majority of the facilities (for which the Agency is responsible for sustainment) are not under DLA's operational control, e.g., fuel storage and handling facilities. Condition assessments from the Military Services on these facilities have not been made available to DLA. The Agency has previously conducted comprehensive condition assessments on some non-fuel facilities only as part of Base Realignment and Closure (BRAC) analyses. Insufficient human and financial resources are available to annually assess Agency facilities and manage the resulting data. It is not anticipated that DLA will fully implement a program to address deferred maintenance, until the decisions from the current BRAC effort are announced.

Intragovernmental Schedule – Part A
As of September 30, 2002
(\$ In Thousands)

Required Supplemental Information – Part A, DoD Intragovernmental Asset Balances

	Treasury <u>Index</u>	Accounts <u>Receivable</u>	<u>Other</u>
Government Printing Office	4	\$ (1)	\$ -
The Judiciary	10	1	-
Executive Office of the President	11	342	-
Department of Agriculture	12	6,929	-
Department of Commerce	13	183	-
Department of the Interior	14	1,381	-
Department of Justice	15	9,098	-
Department of Labor	16	4,691	-
Navy General Fund	17	94,615	-
United States Postal Service	18	163	-
Department of State	19	2,709	-
Department of Treasury	20	3,360	-
Army General Fund	21	116,282	-
Office of Personnel Management	24	38	-
Federal Communications Commission	27	1	-
Social Security Administration	28	33	-
Nuclear Regulatory Commission	31	1	-
Smithsonian Institution	33	1	-
International Trade Commission	34	1	-
Department of Veterans Affairs	36	2,740	-
General Service Administration	47	26,898	-
National Science Foundation	49	140	-
Air Force General Fund	57	55,248	-
Federal Emergency Management Agency	58	131	-
Tennessee Valley Authority	64	10	-
United States Information Agency	67	668	-
Environmental Protection Agency	68	54	-
Department of Transportation	69	16,742	-
Agency for International Development	72	15	-
Small Business Administration	73	70	-
Department of Health and Human Services	75	2,746	-
National Aeronautics & Space Administration	80	8,771	-
Armed Forces Retirement Home	84	953	-
Department of Housing and Urban Development	86	28	-

Intragovernmental Schedule – Part A
As of September 30, 2002
(\$ In Thousands)

Required Supplemental Information – Part A, DoD Intragovernmental Asset Balances (cont.)

	Treasury <u>Index</u>	Accounts <u>Receivable</u>	<u>Other</u>
Department of Energy	89	1,120	-
Department of Education	91	3	-
Independent Agencies	95	20,174	-
U.S. Army Corps of Engineers	96	8,282	-
Other Defense Organizations General Funds	97	129,964	-
Other Defense Organizations Working Capital Funds	97-4930	39,510	-
Army Working Capital Fund	97-4930.001	29,482	5
Navy Working Capital Fund	97-4930.002	141,785	-
Air Force Working Capital Fund	97-4930.003	<u>106,850</u>	-
Totals		<u>\$ 832,212</u>	<u>\$ 5</u>

Intragovernmental Schedule – Part B
As of September 30, 2002
(\$ In Thousands)

Required Supplemental Information – Part B, DoD Intragovernmental Entity Liabilities

	Treasury <u>Index</u>	Accounts <u>Receivable</u>	<u>Other</u>
Department of Labor	16	\$ -	\$ 39,399
Navy General Fund	17	13,471	-
Department of Treasury	20	-	542
Army General Fund	21	7,351	-
Office of Personnel Management	24	-	7,948
U.S. Army Corps of Engineers	96	12	-
Other Defense Organizations General Funds	97	3,789	-
Other Defense Organizations Working Capital Funds	97-4930	53,630	-
Army Working Capital Fund	97-4930.001	572	-
Navy Working Capital Fund	97-4930.002	6,204	-
Air Force Working Capital Fund	97-4930.003	<u>57,929</u>	-
Totals		<u>\$ 142,958</u>	<u>\$ 47,889</u>

Intragovernmental Schedule – Part C
For the Year Ended September 30, 2002
(\$ In Thousands)

Required Supplemental Information – Part C, DoD Intragovernmental Revenue

	Treasury <u>Index</u>	Earned <u>Revenue</u>
Other Legislative Branch Agencies	9	\$ (1)
The Judiciary	10	1
Executive Office of the President	11	1,503
Department of Agriculture	12	47,548
Department of Commerce	13	1,801
Department of Interior	14	371
Department of Justice	15	19,793
Department of Labor	16	12,787
Navy General Fund	17	3,035,685
United States Postal Service	18	821
Department of State	19	6,319
Department of Treasury	20	8,557
Army General Fund	21	3,006,304
United States Tax Court	23	1
Office of Personnel Management	24	17
Social Security Administration	28	50
Nuclear Regulatory Commission	31	1
International Trade Commission	34	6
Department of Veterans Affairs	36	7,877
Merit Systems Protection Board	41	3
U.S. Equal Employment Opportunity Commission	45	1
General Service Administration	47	30,521
National Science Foundation	49	4,824
Air Force General Fund	57	3,238,642
Federal Emergency Management Agency	58	152
Tennessee Valley Authority	64	69
United States Information Agency	67	665
Environmental Protection Agency	68	237
Department of Transportation	69	99,815
Agency of International Development	72	4
Small Business Administration	73	302
Department of Health and Human Services	75	12,066
National Aeronautics and Space Administration	80	33,614
Armed Forces Retirement Home	84	2,348

Intragovernmental Schedule – Part C
For the Year Ended September 30, 2002
(\$ In Thousands)

Required Supplemental Information – Part C, DoD Intragovernmental Revenue (cont.)

	Treasury <u>Index</u>	Earned <u>Revenue</u>
Department of Housing and Urban Development	86	199
Department of Energy	89	6,581
Department of Education	91	15
Independent Agencies	95	58,669
U.S. Army Corps of Engineers	96	1,709
Other Defense Organizations General Funds	97	1,555,596
Other Defense Organizations Working Capital Fund	97-4930	1,147,233
Army Working Capital Fund	97-4930.001	793,744
Navy Working Capital Fund	97-4930.002	2,695,063
Air Force Working Capital Fund	97-4930.003	3,603,730
Totals		\$ 19,435,243

Intragovernmental Schedule – Part E
For the Year Ended September 30, 2002
(\$ In Thousands)

Required Supplemental Information – Part E, DoD Intragovernmental Nonexchange Revenue

	Treasury <u>Index</u>	Transfers- <u>In</u>	Transfers- <u>Out</u>
Other Defense Organizations General Funds	97	\$ 6,192	\$ -
Other Defense Organizations Working Capital Funds	97-4930	3,307	473,798
Air Force Working Capital Fund	97-4930.003	-	78,000
Totals		\$ 9,499	\$ 551,798

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SUPPLY MANAGEMENT ACTIVITY GROUP

Supply Management Overview

Defense Working Capital Fund

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SUPPLY MANAGEMENT ACTIVITY GROUP

Overview

The Supply Management Activity Group consists of three supply centers, one support center, two service centers and other corporate activities. The supply centers are located at the Defense Supply Center Columbus (DSCC) in Columbus, Ohio; the Defense Supply Center Richmond (DSCR) in Richmond, Virginia; and the Defense Supply Center Philadelphia (DSCP) in Philadelphia, Pennsylvania. Each supply center acts as a lead center for one or more commodities. The Defense Energy Support Center (DESC), which is located at Fort Belvoir, Virginia, purchases, manages, positions, and sells fuel to the Military Departments and provides centralized support to meet the energy needs of the military installations. The Service Centers are the Defense Logistics Information Service (DLIS) and Defense Automatic Addressing Service Center (DAASC).

The group's mission is to provide materiel and services to support peacetime and combat operations, combat preparedness and humanitarian aid. This includes integrated materiel management of more than 4 million spare and repair parts supporting over 1,300 weapon systems. Supply Management also provides management of construction and general supplies and troop support items such as food, clothing and textiles, and medical supplies and sells over 100 million barrels of fuel annually. Together, the more than 11,000 personnel that support this business area generated revenue that totaled about \$19.6 billion during FY 02. This is an increase of over \$3 billion from the previous year.

Mission

The mission of the Supply Management Activity Group is to provide customer support by managing logistics processes, to ensure that logistics support is provided to the Military Services worldwide at the right time, to the right place, and consistently at the best value in peacetime, emergency, and wartime scenarios. The support

requirements are dynamic, and we continue to shift our approach in response to evolving changes in national priorities, requirements of the Military Services, technology, and the commercial marketplace. The primary logistics functions include:

- Supply-chain integration and inventory management;
- Transportation management (shared with the Distribution Activity Group);
- Technical management, which guarantees product quality and proper pricing of materiel;
- Procurement management, ensuring DoD gets the best value;
- Logistics data and information collection, management, and distribution, and providing for the integration and availability of this information; and
- Logistics management process and processing of logistics and standard MILS transactions

Strategic Goals

The long-term goals of the Supply Management Activity Group are consistent with the goals contained in the DLA Strategic Plan. These goals will be achieved through a series of supporting strategies and executed by the three supply centers and the energy support center.

FY 02 Accomplishments

Army Partnership Results in Increased Sales. Continuing efforts to strengthen the DLA/Army partnership resulted in a 36 percent increase - \$414.1 million to \$565.1 million - in medical sales to the Army. Improved the automation of Army local procurements that are supported by DLA's Working Capital Fund. The benefit of this partnership is also recognized by the responsiveness - \$48 million in sales - to Operation Enduring Freedom, especially by the Army-DLA forward business location at Pirmasens, Germany, the U.S. Army Medical Materiel Center Europe.

Aviation Investment Strategy (AIS) Results in Supply Availability Gains. Included in the 4.1 million items that DLA supports are more than 1.2 million aviation spare parts. The inventory optimization models DLA uses are configured to maximize customer satisfaction by filling the most orders for the most customers. This configuration more favorably supports the low-cost high-demand items and does not adequately support the aviation parts that are generally expensive with less frequent demand. This resulted in a disproportionately adverse effect on the readiness of the Military Services' aviation weapon systems. The AIS is a four year \$500 million program to improve the availability of these aviation spare parts and targets these funds to specific support categories: Replenishment items for Engines, \$120 million, Non-engines, \$334 million, and Numeric Stockage Objective (NSO) items, \$46 million. An NSO item is an item with either extremely low demand or an "insurance" item. When NSO items are not available, they require long lead times to purchase and very long lead times to manufacture. The AIS investments in FY 00 (\$121.1 million) and FY 01 (\$146 million) are paying off. For example, the supply availability of the AIS items was less than 60 percent in both FY 98 and FY 99. By the end of FY 02, the supply availability of these same items rose to 81 percent for Engine items and 74.6 percent for non-engine items. The FY 02 (\$146.2 million) and FY 03 (\$86.7 million) investments will result in further improvements.

Program Performance Measures

Customer Satisfaction Index: This index measures the percentage of customers who responded to our periodic mail-out surveys that they were either "satisfied" or "very satisfied" with DLA's products and services. The overall satisfaction metric is a composite of how well (in the customers' perception) the Agency meets customer expectations in each of these areas.

During FY 02, DLA's Logistics Operations mailed out three waves of surveys: November 2001, April 2002, and July 2002. Each wave surveyed a different random sample of customers from a population that specifically targeted DLA's non-energy customers. More than 2,400 responses were received and the results showed marked improvement in customer satisfaction over the last two years. The greatest improvement between FY 01 and FY 02 occurred at Defense Supply Center Philadelphia (DSCP), which was driven by an increase in their General and Industrial, and Clothing and Textile commodities.

CUSTOMER SATISFACTION INDEX FOR SUPPLY MANAGEMENT (NON-ENERGY)

“Satisfied” and “Very Satisfied” Responses



The other performance metrics covered in this report, Weapon System Supply Availability by Service, details progress made toward meeting customer expectations. However, the survey also identifies customer service factors such as effective information provided by DLA and responsiveness to calls and inquiries. The results of these surveys indicate there is room for improvement in these areas. We will continue to reinforce our current focus on

customers, as specifically outlined in the DLA Strategic Plan, Balanced Scorecard and Customer Relationship Management initiative, to meet customer expectations in all areas identified by customers as important to them.

The following metric directly supports the DLA Strategic Plan goal to consistently provide responsive services to our customers:

Weapon System Supply Availability by Service: This performance metric measures our capability to ensure that weapon system supplies are available when needed and that we provide each Service with a minimum level of performance.

The following chart portrays our accomplishment – continuous improvement from FY 00 through FY 02 – relative to the Department’s 85 percent supply availability goal.

Weapon System Supply Availability			Goal FY 02	Actual FY 02
	FY 00	FY 01		
Army	85.3%	88.8%	89.3%	90.7%
Air Force	81.5%	81.8%	84.0%	84.0%
Navy	84.1%	84.4%	85.0%	85.9%
USMC	88.7%	90.3%	90.5%	91.7%

The chart below is an isolated quarterly view of our FY 02 progress showing that we progressively improved support for both the Navy and Air Force. Our Fourth Quarter, FY 02 Weapon System Supply Availability was the highest that it has been for each Service since at least FY 95.

	1st Qtr FY 02	2nd Qtr FY 02	3rd Qtr FY 02	4th Qtr FY 02	CUM FY 02
Army	89.8%	90.6%	90.8%	91.3%	90.7%
Air Force	82.4%	83.2%	84.0%	86.2%	84.0%
Navy	84.2%	85.6%	85.8%	87.4%	85.9%
USMC	91.2%	91.6%	91.8%	92.2%	91.7%

Financial Performance Measures

DLA establishes its prices predicated on three primary factors: (1) its current financial position, as determined by the Accumulated Operating Result (AOR); (2) its projected cash position relative to the stated objective and; (3) the estimated expenses that will be incurred to generate the estimated revenue. It is Agency policy to set prices that achieve an AOR of zero over the long-term and maintain cash balances that preclude an Anti-Deficiency Act violation. In addition, not all costs attributed to the business are recovered by the business - imputed costs, depreciation expenses applied to investments funded from General Fund accounts, and the recording of revenue that is for non-expense items (peacetime inventory augmentation, mobilization inventories, and adjustments to the cash position). The Results section below more fully describes DLA achievement during FY 02.

DLA measures the effectiveness of program budgeting and execution with unit cost performance measures. The following table depicts the Supply Management unit cost results for the fuel commodity and the composite non-energy commodities:

	FY 02 Goal	FY 02 Actual
Cost per Barrel of Fuel	\$30.21	\$40.49
Non-Energy Cost per Dollar of sales	\$ 1.03	\$ 1.07

The cost per barrel of fuel includes the acquisition cost of a barrel of petroleum product in addition to operations costs for fuel services, transportation, and overhead. The actual cost per barrel was higher than our goal due to higher than expected per product costs (\$32.89 vs. \$24.07), which was slightly offset by higher than planned sales (132.3 million barrels vs. 110.2 million barrels) and lower than planned per barrel costs of operations (\$6.14 vs. \$7.60).

The unit cost for non-energy was over plan by \$0.04. The actual unit cost was higher than the FY 02 goal because of increases in materiel obligations that supported: (1) Operation Enduring Freedom, \$633 million in sales; (2) efforts to reduce customer backorders, \$258 million funded; and (3) an increase in supply availability, \$142.6 million invested.

Results

The FY 02 Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over

expenses of more than \$1.4 billion and is more than \$600 million greater than the planned gain of just less than \$800 million. This gain consists of five primary components: The first is the effect of Operation Enduring Freedom, which generated almost \$500 million in excess of revenue over expenses in our non-energy business. The second is the impact of petroleum product costs that resulted of excess expenses relative to revenue by more than \$158 million. The third component is the effect of cleaning up prior year accounting records. This clean up accounts for more than \$70 million in reduced FY 02 expenses. Fourth is the reduction, more than \$27 million, of DLA's Federal Employees Compensation Act (FECA) liability. The fifth primary cause is the recognized gains, more than \$146 million to our inventory.

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Supply Management Comparative Financial Statements

**AS OF AND FOR THE YEARS ENDED
SEPTEMBER 30, 2002 AND 2001**

Defense Working Capital Fund

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Comparative Balance Sheets
As of September 30, 2002 and 2001
(In Thousands)

	2002	2001
ASSETS		
Intragovernmental:		
Fund Balance with Treasury	\$ -	\$ -
Accounts Receivable	723,355	614,816
Other Assets	<u>239</u>	<u>239</u>
Total Intragovernmental Assets	723,594	615,055
Accounts Receivable	443,291	264,957
Inventory and Related Property	11,525,134	10,880,979
General Property, Plant and Equipment	712,842	681,743
Other Assets	<u>224,140</u>	<u>229,472</u>
TOTAL ASSETS	\$ 13,629,001	\$12,672,206
LIABILITIES		
Intragovernmental:		
Accounts Payable	\$ 196,921	\$ 205,869
Environmental Liabilities	-	-
Other Liabilities	<u>25,064</u>	<u>162,924</u>
Total Intragovernmental Liabilities	221,985	368,793
Accounts Payable	1,386,159	1,313,849
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities	101,080	128,319
Environmental Liabilities	-	-
Other Liabilities	<u>219,057</u>	<u>72,656</u>
TOTAL LIABILITIES	1,928,281	1,883,617
NET POSITION		
Cumulative Results of Operations	<u>11,700,720</u>	<u>10,788,589</u>
TOTAL NET POSITION	<u>11,700,720</u>	<u>10,788,589</u>
TOTAL LIABILITIES AND NET POSITION	\$ 13,629,001	\$12,672,206

Comparative Statements of Net Cost
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Program Costs		
Intragovernmental Gross Costs	\$1,801,611	\$1,483,846
Less: Intragovernmental Earned Revenue	<u>(18,240,558)</u>	<u>(15,480,986)</u>
Intragovernmental Net Costs	(16,438,947)	(13,997,140)
Gross Costs With the Public	16,386,234	15,364,606
Less: Earned Revenue From the Public	<u>(1,356,409)</u>	<u>(1,049,765)</u>
Net Costs With the Public	<u>15,029,825</u>	<u>14,314,841</u>
Total Net Cost	<u>(1,409,122)</u>	<u>317,701</u>
Net Cost of Operations	<u>\$ (1,409,122)</u>	<u>\$ 317,701</u>

Comparative Statements of Net Position
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002		2001	
	Cumulative Results of Operations	"Unexpended Appropriations"	Cumulative Results of Operations	"Unexpended Appropriations"
Beginning Balances	\$10,788,589	\$-	\$8,906,991	\$1,556,200
Budgetary Financing Sources:				
Appropriations received	-	-	-	(1,556,200)
Appropriations transferred-in/out	-	75,000	-	-
Appropriations used	75,300	(75,000)	1,557,251	-
Other budgetary financing sources	4,636	-	(128,859)	-
Other Financing Sources:				
Transfers-in/out without reimbursement	(643,352)	-	708,354	-
Imputed financing from costs absorbed by others	<u>66,426</u>	<u>-</u>	<u>62,553</u>	<u>-</u>
Total Financing Sources	(496,990)	-	2,199,299	(1,556,200)
Net Cost of Operations	<u>(1,409,122)</u>	<u>-</u>	<u>317,701</u>	<u>-</u>
Ending Balances	<u>\$ 11,700,721</u>	<u>\$ -</u>	<u>\$ 10,788,589</u>	<u>\$ -</u>

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2002 and 2001
(In Thousands)

2002 2001

Budgetary Resources:

Budget Authority:		
Appropriations received	\$ 75,300	\$ 1,050
Contract authority	335,738	1,854,667
Unobligated balance:		
Beginning of period	355,915	1,274,932
Net transfers, actual	-	(919,290)
Spending authority from offsetting collections:		
Earned		
Collected	18,862,715	16,180,771
Receivable from Federal sources	304,121	(215,686)
Change in unfilled customer orders		
Advance received	4,922	-
Without advance from Federal sources	305,675	54,458
Subtotal	19,477,433	16,019,543
Recoveries of prior year obligations	31	-
Permanently not available	75,000	(1,138,362)
Total Budgetary Resources	\$ 20,319,417	\$ 17,092,540

Status of Budgetary Resources:

Obligations incurred:		
Direct	\$ -	\$ (1,806,545)
Reimbursable	19,691,875	18,543,171
Subtotal	19,691,875	16,736,626
Unobligated balance:		
Apportioned	627,542	355,914
Total, Status of Budgetary Resources	\$ 20,319,417	\$ 17,092,540

Relationship of Obligations to Outlays:

Obligated Balance, Net - beginning of period	\$ 6,135,152	\$ 6,048,554
Obligated Balance, Net - end of period:		
Accounts receivable	(1,182,122)	(878,002)
Unfilled customer order from Federal sources	(1,835,880)	(1,530,204)
Undelivered orders	8,002,588	6,769,557
Accounts payable	1,854,158	1,773,801
Outlays:		
Disbursements	18,378,455	16,815,122
Collections	(18,867,637)	(16,180,772)
Subtotal	(489,182)	634,350
Net Outlays	\$ (489,182)	\$ 634,350

Comparative Statements of Financing
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	\$ 19,691,875	\$ 16,736,626
Less: Spending authority from offsetting collections and recoveries	(19,477,464)	(16,019,543)
Obligations net of offsetting collections and recoveries	214,411	717,083
Net obligations	214,411	717,083
Other Resources		
Transfers in/out without reimbursement	2,045	(360)
Imputed financing from costs absorbed by others	66,426	62,553
Net other resources used to finance activities	68,471	62,193
Total resources used to finance activities	282,882	779,276
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	(1,228,108)	8,343
Unfilled Customer Orders	310,598	54,458
Resources that fund expenses recognized in prior periods	(32,431)	(2,156)
Resources that finance the acquisition of assets	(659,238)	(411,452)
Other	-	(153,700)
Total resources used to finance items not part of the net cost of operations	(1,609,179)	(504,507)
Total resources used to finance the net cost of operations	(1,326,297)	274,769
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	3,452	-
Other	-	11,258
Total components of Net Cost of Operations that will require or generate resources in future periods	3,452	11,258
Components not Requiring or Generating Resources		
Depreciation and amortization	59,363	36,845
Revaluation of assets or liabilities	(171,638)	(5,171)
Other	25,998	-
Total components of Net Cost of Operations that will not require or generate resources	86,277	31,674
Total components of net cost of operations that will not require or generate resources in the current period	82,825	42,932
Net Cost of Operations	\$ (1,409,122)	\$ 317,701

DISTRIBUTION ACTIVITY GROUP

Distribution Overview

Defense Working Capital Fund

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DISTRIBUTION ACTIVITY GROUP

Overview

The Distribution Activity Group operates through the Defense Distribution Center and 22 subordinate distribution centers located throughout the United States and Europe and in the Pacific region. The group's mission is to manage the receipt, storage, and issue of DoD materiel. It may deliver that materiel to customers located on bases or to far-off ships, posts and repair facilities. The activity group also contracts with commercial sources to transport items from vendor-owned and DLA-owned warehouses direct to customers worldwide. Some distribution centers are highly automated facilities that were specifically designed to provide global support for general commodities. Others fill customer requirements on a regional basis, or provide global support for materiel that requires special equipment, facilities, or training. The distribution centers maintain the accountable inventory records and are responsible for preserving about \$80.5 billion in DoD materiel (at selling price), representing over 4 million items. They processed over 23 million receipt and issue transactions during FY 02, which generated revenues of more than \$1.4 billion. This activity group employs approximately 8,370 civilian and 116 military personnel.

Mission

The mission of the Distribution Activity Group is the global distribution and warehousing of DoD materiel, including weapon systems parts, consumable items (such as medical, clothing, subsistence, electrical, industrial and general supplies), repairable spare parts, and end-items. It performs this mission by managing materiel and logistics information to enable a seamless, worldwide distribution network that provides effective and efficient support to the Combatant Commanders, Military Services and others, in Theater and out, during war and peace. The distribution network ensures that America's warfighters receive competitively priced and best value distribution services by providing "around the clock - around the world," world-class service.

Strategic Goals

The strategic goals established by the Distribution Activity Group are consistent with those contained in the DLA Strategic Plan. These goals are achieved through a series of supporting strategies that will:

- Increase our reliability, response time, and value to our customers by continuously improving and reengineering business practices.
- Provide best-value solutions to our customers by continuously evaluating our activities and implementing changes, as necessary, to ensure efficient and effective distribution operations.
- Reduce under-utilized infrastructure by eliminating unnecessary storage capacity.

FY02 Accomplishments

Infrastructure Cost Reduction through A-76 Cost Comparisons. In FY 98, we began the process of competing our depots with private industry. The goal of these competitions is to reduce operational costs either by reengineering existing depot business processes or contracting out the distribution functions. Thus far, nine sites have been competed with the Government retaining depot operations at three sites, while the other six were contracted with private industry. The estimated long-term (FY 98 - FY 09) net savings from these nine competitions is in excess of \$175 million. Four of these nine competition decisions were made during FY 02: San Diego, CA and Hill, UT distribution centers were privatized; while the distribution centers at Richmond, VA; and Albany, GA were retained by the Government. Seven additional sites are undergoing study.

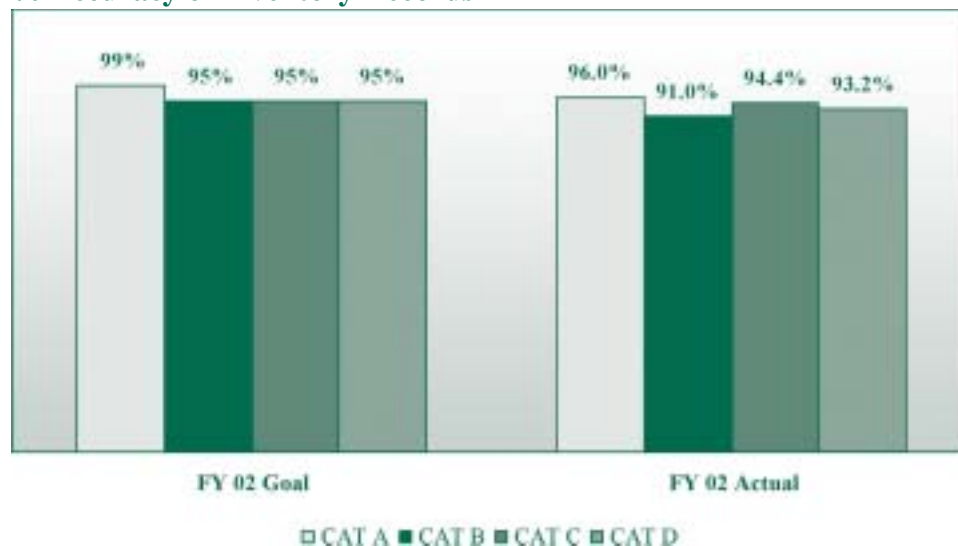
Program Performance Measures

Inventory Record Accuracy. This performance metric measures the accuracy of inventory records using statistical sampling techniques, which are performed semi-annually. Starting in FY 99, DLA incorporated established DoD stratification and tolerance levels into the inventory sampling methodology. The DoD plan takes into consideration item characteristics such as dollar value, and provides a means to focus resources commensurate with the significance of the errors found. FY 02 goals for inventory accuracy are 99 percent for items in the high

dollar strata, Category (A); and 95 percent for the remaining three strata. Our record accuracy for the high dollar Category (A) is 96.0 percent; Category (B) is 91.0 percent; Category (C) 94.4 percent; and Category (D) is 93.2 percent.

The reasons we were unable to achieve our goals are due primarily to staff reductions and uncertainty caused by the ongoing and planned public-private competitions.

Inventory Accuracy
% Accuracy of Inventory Records



Category A: Unit Price > \$1,000

Category B: Unit of Issue Not Equal to Each OR
On-Hand Balance > 50 AND Extended Dollar Value
< \$50,000 OR Activity > 50

Category C: On-Hand Balance < 50 AND Date of
Last Inventory > 24 Months

Category D: All Others

Storage Space Utilization. The goal of increasing space utilization ties directly to the goal in the DLA strategic plan to structure internal processes to deliver customer outcomes effectively and efficiently. In an effort to reduce infrastructure costs, we continuously evaluate our storage

capacity and occupancy to identify improvements in space utilization and eliminate unnecessary space. This performance goal measures space occupancy. In FY 02, our space utilization rate was 67 percent, which exceeded our goal by 1 percent.

Utilization Rates



Financial Performance Measures

We measure the effectiveness of program budgeting and execution with unit cost performance measures. The following table depicts the Distribution unit cost results for processing and storage cost rates.

	FY 02 Goal	FY 02 Actual
Unit Cost-Total Composite Processing Rate	\$26.45	\$25.02
Unit Cost- Covered Storage	\$.99	\$.93

The Unit Cost-Total Composite Processing Rate measures processing costs (direct, indirect, and applied overhead) relative to the number of line items (receipts and issues) processed.

The Unit Cost-Covered Storage measures the costs (direct, indirect, and applied overhead) to provide covered storage to the cubic footage used.

We bettered these goals due to two primary management efforts: First, the success of our competition efforts in reducing personnel and infrastructure costs. Second, an effort to eliminate aged balances (both unliquidated obligations and aged payables) and produced significant reductions, \$161.5 million, to the business area's operating obligations. These balances were primarily derived from business processes that were in effect prior to FY 98 when the Distribution business area consolidated and centralized its financial operations under the control of the DDC. Prior to the consolidation, each distribution center was supported by one or more databases that maintained its accounting records. In FY 02, the DDC undertook a major initiative to analyze and validate these previously decentralized records. That analysis revealed a large number of unprocessed documents. As a result of the review, a total of \$169.9 million was de-obligated including \$8.4 million attributed to DLA's investment account, the Capital Budget.

Results

The FY 02 Net Cost of Operations, which includes costs not recovered by the Defense-wide Working Capital Fund (military construction depreciation, imputed expenses, and accounting adjustments), reflects an excess of revenue over expenses of almost \$68 million and is more than \$180 million greater than the planned loss of about \$114 million. This gain consists of four primary components: The first is the effect of Operation Enduring Freedom, which generated about \$70 million in excess of revenue

over expenses. The second is the effect of cleaning up prior year accounting records. This clean up accounted for almost \$128 million in reduced FY 02 expenses. Third is the reduction, more than \$13 million, of DLA's Federal Employees Compensation Act (FECA) liability. The fourth primary cause is the change in policy and the subsequent recognition of an almost \$26 million liability associated with the unfunded annual leave.

Distribution Comparative Financial Statements

**AS OF AND FOR THE YEARS ENDED
SEPTEMBER 30, 2002 AND 2001**

Defense Working Capital Fund

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Comparative Balance Sheets
As of September 30, 2002 and 2001
(In Thousands)

2002 2001

ASSETS

Intragovernmental:

Fund Balance with Treasury	\$ -	\$ -
Accounts Receivable	203,759	113,013
Other Assets	<u>5</u>	<u>1</u>
Total Intragovernmental Assets	203,764	113,014

Accounts Receivable	525	1,271
General Property, Plant and Equipment	478,114	393,044
Other Assets	<u>457</u>	<u>537</u>

TOTAL ASSETS	<u>\$ 682,860</u>	<u>\$ 507,866</u>
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LIABILITIES

Intragovernmental:

Accounts Payable	\$ 125,486	\$ 38,408
Environmental Liabilities	-	-
Other Liabilities	<u>15,980</u>	<u>17,158</u>
Total Intragovernmental Liabilities	141,466	55,566

Accounts Payable	1,036	258,155
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Military Retirement Benefits and Other Employment-Related Actuarial Liabilities	69,170	82,372
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Environmental Liabilities	-	-
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Other Liabilities	<u>31,915</u>	<u>31,659</u>
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TOTAL LIABILITIES	243,587	427,752
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NET POSITION

Cumulative Results of Operations	<u>439,273</u>	<u>80,114</u>
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TOTAL NET POSITION	<u>439,273</u>	<u>80,114</u>
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TOTAL LIABILITIES AND NET POSITION	<u>\$ 682,860</u>	<u>\$ 507,866</u>
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Comparative Statements of Net Cost
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Program Costs		
Intragovernmental Gross Costs	\$ 622,193	\$ 358,284
Less: Intragovernmental Earned Revenue	<u>(1,461,252)</u>	<u>(1,205,061)</u>
Intragovernmental net Costs	(839,059)	(846,777)
Gross Costs With the Public	773,699	992,565
Less: Earned Revenue From the Public	<u>(2,243)</u>	<u>(4,797)</u>
Net Costs With the Public	<u>771,456</u>	<u>917,768</u>
Total Net Cost	<u>(67,603)</u>	<u>70,991</u>
Net Cost of Operations	<u>\$ (67,603)</u>	<u>\$ 70,991</u>

Comparative Statements of Net Position
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Cumulative Results of Operations	2001 Cumulative Results of Operations
Beginning Balances	\$ 80,114	\$ 161,005
Budgetary Financing Sources:		
Appropriations used	300	1,385
Other Financing Sources:		
Transfers-in/out without reimbursement	251,343	(55,042)
Imputed financing from costs absorbed by others	<u>39,913</u>	<u>43,757</u>
Total Financing Sources	291,556	(9,900)
Net Cost of Operations	<u>(67,603)</u>	<u>(70,991)</u>
Ending Balances	<u>\$ 439,273</u>	<u>\$ 80,114</u>

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Budgetary Resources:		
Budget Authority:		
Appropriations received	\$ 300	\$ 1,385
Unobligated balance:		
Beginning of period	105,371	74,407
Spending authority from offsetting collections:		
Earned		
Collected	1,373,366	1,258,806
Receivable from Federal sources	90,129	(48,948)
Change in unfilled customer orders		
Without advance from Federal sources	<u>(77,083)</u>	<u>27,791</u>
Subtotal	1,386,412	1,237,649
Permanently not available	<u>(50,798)</u>	<u>(36,217)</u>
Total Budgetary Resources	<u>\$ 1,441,285</u>	<u>\$ 1,277,224</u>
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ -	\$ (342,737)
Reimbursable	<u>1,317,128</u>	<u>1,514,590</u>
Subtotal	1,317,128	1,171,853
Unobligated balance:		
Apportioned	<u>124,157</u>	<u>105,371</u>
Total, Status of Budgetary Resources	<u>\$ 1,441,285</u>	<u>\$ 1,277,224</u>
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	\$ 259,114	\$ 318,641
Obligated Balance, Net - end of period:		
Accounts receivable	(204,275)	(114,147)
Unfilled customer orders from Federal sources	(94,465)	(171,547)
Undelivered orders	231,709	240,642
Accounts payable	135,510	304,166
Outlays:		
Disbursements	1,494,717	1,252,537
Collections	<u>(1,373,366)</u>	<u>(1,258,806)</u>
Subtotal	<u>121,351</u>	<u>(6,269)</u>
Net Outlays	<u>\$ 121,351</u>	<u>\$ (6,269)</u>

Comparative Statements of Financing
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
<i>Resources Used to Finance Activities:</i>		
Budgetary Resources Obligated		
Obligations incurred	\$ 1,317,128	\$ 1,171,853
Less: Spending authority from offsetting collections and recoveries	<u>(1,386,412)</u>	<u>(1,237,649)</u>
Obligations net of offsetting collections and recoveries	<u>(69,284)</u>	<u>(65,796)</u>
Net obligations	(69,284)	(65,796)
Other Resources		
Imputed financing from costs absorbed by others	<u>39,913</u>	<u>43,757</u>
Net other resources used to finance activities	<u>39,913</u>	<u>43,757</u>
Total resources used to finance activities	(29,371)	(22,039)
<i>Resources Used to Finance Items not Part of the Net Cost of Operations:</i>		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	9,931	41,576
Unfilled Customer Orders	(77,083)	27,791
Resources that fund expenses recognized in prior periods	(15,509)	(3,251)
Resources that finance the acquisition of assets	<u>(24,945)</u>	<u>(24,949)</u>
Total resources used to finance items not part of the net cost of operations	<u>(107,606)</u>	<u>41,167</u>
Total resources used to finance the net cost of operations	(136,977)	19,128
<i>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</i>		
Components Requiring or Generating Resources in Future Periods		
Other	<u>-</u>	<u>1,018</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	-	1,018
Components not Requiring or Generating Resources		
Depreciation and amortization	<u>69,374</u>	<u>50,845</u>
Total components of Net Cost of Operations that will not require or generate resources	<u>69,374</u>	<u>50,845</u>
Total components of net cost of operations that will not require or generate resources in the current period	<u>69,374</u>	<u>51,863</u>
Net Cost of Operations	\$ (67,603)	\$ 70,991

DEFENSE REUTILIZATION AND MARKETING ACTIVITY GROUP

Reutilization and Marketing Overview

Defense Working Capital Fund

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DEFENSE REUTILIZATION AND MARKETING ACTIVITY GROUP

Overview

The Defense Reutilization and Marketing Service (DRMS) coordinates the reuse of excess and surplus DoD property. The reutilization of excess materiel by DoD customers reduces the need to purchase new materiel. In FY 02, materiel with an acquisition value of \$11.9 billion was turned in to DRMS and \$1.2 billion was reutilized within DoD. DRMS also oversees the demilitarization (DEMIL) and disposal of the remaining property through transfers, donations, and sales; or its ultimate disposal as in the case with hazardous waste.

The DRMS headquarters is located in Battle Creek, MI; and its mission is accomplished through 94 Defense Reutilization and Marketing Offices (DRMOs) located on military installations throughout the world. DRMOs receive, classify, segregate, demilitarize, account for and report excess materiel for screening, lot categorization, merchandising and sale. The FY 02 mission was performed with just over 1,600 personnel and generated revenues of \$351 million.

Mission

DRMS manages the reutilization, transfer, donation, and sale of military personal property, as well as disposal of hazardous waste items no longer needed for national defense. Its mission is to maximize the financial return on the initial equipment investment, conserve valuable natural resources, and protect the environment.

Strategic Goals

The long-term goals of the Reutilization and Marketing activity group are consistent with the goals contained in the DLA Strategic Plan. These goals are achieved through a series of supporting objectives and initiatives designed to improve and reengineer business practices to ensure efficient, effective, and best-value operational support.

FY 02 Accomplishments

• Automation

- o Sales Customers Make Credit Card Payments Via The Web. DRMS engaged a team comprised of the U.S. Treasury, Northrop Grumman Information Technology, Govolution Incorporated, and Mellon Bank to develop and implement a project that allows sales customers – the general public – to make credit card payments via the internet. While this initiative generated modest revenue, collections valued at less than \$200,000, during this initial phase, we expect that this payment vehicle will eventually generate a significant portion of our sales proceeds. In a related initiative, DRMS will implement (in early FY 03) the capability for customers to make payments via Electronic Funds Transfer from the DRMS web site.
- o Electronic Turn-In Document (ETID). After implementing a successful prototype in FY 01, DRMS continues to promote the web-based ETID program to optimize the benefits inherent in automated business processes. ETID simplifies the turn-in process by eliminating the need for customers to prepare a hand-scribed/typewritten turn-in document. The number of customer sites using ETID to turn in property for disposal increased significantly – 14 in FY 01 to 194 by the end of FY 02. The number of ETIDs created also increased from 4,729 in FY 01 to 27,661 in FY 02.

• Operation Enduring Freedom

- o Hazardous Waste (HW) Disposal Support. DRMS awarded a contract to provide HW disposal services in Afghanistan, Pakistan, Uzbekistan, Tajikistan and Kyrgyzstan. DRMS held a post-award conference to ensure that the contract terms and conditions were fully understood by the interested parties – U.S. military representatives from these countries, representatives from Central Command and the

contractor. The conference was considered a major success, as much needed information was disseminated to the logistics personnel in the field. This contract has four option years with a potential aggregate cost of \$4.9 million. DRMS is also working with U.S. military officials regarding disposal options for HW being generated by U.S. forces operating in the Philippines.

- o **Reutilization.** Operation Enduring Freedom screeners have been actively requisitioning property from several overseas DRMOs. Items reutilized included floodlights, water cans, weapon parts, HUMVEES, utility vehicles, tools, clothing, sleeping bags and mats, field packs and frames, goggles, and camera units to support the troops.

Program Performance Measures

Reutilization/Transfer/Donation (R/T/D). This indicator represents the aggregate acquisition value of the property reutilized, transferred and donated, expressed as a percentage of acquisition value of total dispositions. The indicator applies to the available assets that are economically reused, thus preventing concurrent procurement of new assets. It addresses disposal via reutilization by another defense customer, transfer to another federal agency, or donation to eligible state and local governments or non-profit organizations. R/T/D dispositions, as a percentage of total dispositions, indicate compliance with federal regulations that mandate reuse through these cost avoidance programs as the first priority of disposal. In FY 02, the reutilization rate met its goal of 13%.

DRMS is facilitating the increase of R/T/D as a percentage of total dispositions by:

- Implementing changes that will improve the information on available property. This includes providing photos on the web and better written descriptions;

- Identifying potential items of interest that may be in batch lots;
- Providing interactive notification lists; and,
- Working closely with ICPs to fulfill backorders.

Financial Performance Measures

We measure the effectiveness of program budgeting and execution with unit cost performance measures. DRMS is measured on four unit cost goals: Reutilization/Transfer/Donation (R/T/D), Ultimate Disposal, Sales Proceeds, and Abandonment & Destruction (A&D). In FY 02 all unit costs were affected by the de-obligation of \$21.6 million in aged accounts payables. The following table depicts the unit cost results for each category:

Financial Performance Measures	FY 02 Goal	FY 02 Actual
Cost incurred per Dollar of Acquisition Value – Reutilization/Transfer/Donation (R/T/D)	\$0.02427	\$0.03797
Cost incurred per Pound – Ultimate Disposal	\$0.177	\$0.181
Cost incurred per Dollar – Sales Proceeds	\$2.1574	\$2.3724
Cost per Pound – Abandonment & Destruction (A&D)	\$0.091	\$0.088

The FY 02 R/T/D actual unit cost was higher than planned because of two policy changes that occurred in FY 01. The first was a General Services Administration moratorium placed on transfers of computers to the

Federal Prison Industries (FPI). FPI was a major customer for computers requesting over \$1 billion worth of transfers in FY 00. Second, DoD mandated the destruction of unclassified computer hard drives, which continues to have a negative impact. The effects of these two changes were partially off-set by program cost decreases, \$5.9 million, due to the de-obligation of aged accounts payables.

The Ultimate Disposal unit cost was higher than planned due to workload that was 3.6% below plan; however, some of this unanticipated negative impact was off-set with program costs reductions, \$3.8 million, attributed to the de-obligation of aged accounts payables.

The Sales Proceeds unit cost was higher than planned because of the lower quantity and quality of receipts and a downturn in the scrap market. However, some of this unanticipated negative impact was off-set with program

costs reductions, \$11.1 million, due to the de-obligation of aged accounts payables.

The A&D unit cost was lower than planned. Workload and costs were above plan due to the Recycling 2000 program in Europe. This contract covers the disposal of solid waste from eight DRMOs located in Germany. The huge impact of this program was underestimated in the workload and cost plans. In addition, program costs were decreased by \$.8 million due to the de-obligation of aged accounts payables.

Results

The Reutilization and Marketing activity group achieved an excess of revenue over expenses of \$51.3 million compared to a plan of \$50.7 million in FY 02.

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Reutilization and Marketing Comparative Financial Statements

**AS OF AND FOR THE YEARS ENDED
SEPTEMBER 20, 2002 AND 2001**

Defense Working Capital Fund

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Comparative Balance Sheets
As of September 30, 2002 and 2001
(In Thousands)

	2002	2001
ASSETS		
Intragovernmental:		
Fund Balance with Treasury	\$ -	\$ -
Accounts Receivable	<u>1,966</u>	<u>16,582</u>
Total Intragovernmental Assets	1,966	16,582
Cash and Other Monetary Assets	4,390	-
Accounts Receivable	11,736	17,762
Inventory and Related Property	-	113,245
General Property, Plant and Equipment	92,616	122,303
Other Assets	<u>39</u>	<u>5,496</u>
TOTAL ASSETS	<u>\$ 110,747</u>	<u>\$ 275,388</u>
LIABILITIES		
Intragovernmental:		
Accounts Payable	\$1,575	\$6,277
Environmental Liabilities	-	-
Other Liabilities	<u>4,425</u>	<u>5,286</u>
Total Intragovernmental Liabilities	6,000	11,563
Accounts Payable	132,569	170,047
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities	19,232	22,251
Environmental Liabilities	-	-
Other Liabilities	<u>41,350</u>	<u>61,146</u>
TOTAL LIABILITIES	199,151	265,007
NET POSITION		
Cumulative Results of Operations	<u>(88,404)</u>	<u>10,381</u>
TOTAL NET POSITION	<u>(88,404)</u>	<u>10,381</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 110,747</u>	<u>\$ 275,388</u>

Comparative Statements of Net Cost
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Program Costs		
Intragovernmental Gross Costs	\$ 81,945	\$ 78,832
Less: Intragovernmental Earned Revenue	<u>(313,538)</u>	<u>(318,808)</u>
Intragovernmental Net Costs	(231,593)	(239,976)
Gross Costs With the Public	217,946	246,442
Less: Earned Revenue From the Public	<u>(37,622)</u>	<u>(52,606)</u>
Net Costs With the Public	<u>180,324</u>	<u>193,836</u>
Total Net Cost	<u>(51,269)</u>	<u>(46,140)</u>
Net Cost of Operations	<u>\$ (51,269)</u>	<u>\$ (46,140)</u>

Comparative Statements of Net Position
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Cumulative Results of Operations	2001 Cumulative Results of Operations
Beginning Balances	\$ 10,381	\$ 53,890
Other Financing Sources:		
Transfers-in/out without reimbursement	(158,579)	(98,774)
Imputed financing from costs absorbed by others	<u>8,524</u>	<u>9,125</u>
Total Financing Sources	(150,055)	(89,649)
Net Cost of Operations	<u>(51,269)</u>	<u>(46,140)</u>
Ending Balances	<u>\$ (88,405)</u>	<u>\$ 10,381</u>

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Budgetary Resources:		
Unobligated balance:		
Beginning of period	\$ 49,267	\$ 50,602
Spending authority from offsetting collections:		
Earned		
Collected	369,860	370,735
Receivable from Federal sources	(18,363)	1,393
Change in unfilled customer orders		
Advance received	(18,855)	(1,481)
Without advance from Federal sources	<u>1,603</u>	<u>(6,030)</u>
Subtotal	334,245	364,617
Permanently not available	<u>(74,812)</u>	<u>(67,057)</u>
Total Budgetary Resources	<u>\$ 308,700</u>	<u>\$ 348,162</u>
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ -	\$ (162,842)
Reimbursable	<u>257,643</u>	<u>461,737</u>
Subtotal	257,643	298,895
Unobligated balance:		
Apportioned	<u>51,057</u>	<u>49,267</u>
Total, Status of Budgetary Resources	<u>\$ 308,700</u>	<u>\$ 348,162</u>
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	\$ 195,352	\$ 185,867
Obligated Balance, Net - end of period:		
Accounts receivable	(15,919)	(34,282)
Unfilled customer orders from Federal sources	(3,055)	(1,454)
Undelivered orders	39,995	53,094
Accounts payable	136,354	177,994
Outlays:		
Disbursements	312,382	294,047
Collections	<u>(351,006)</u>	<u>(369,254)</u>
Subtotal	<u>(38,624)</u>	<u>(75,207)</u>
Net Outlays	<u>\$ (38,624)</u>	<u>\$ (75,207)</u>

Comparative Statements of Financing
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
<i>Resources Used to Finance Activities:</i>		
Budgetary Resources Obligated		
Obligations incurred	\$ 257,643	\$ 298,895
Less: Spending authority from offsetting collections and recoveries	<u>(334,245)</u>	<u>(364,617)</u>
Obligations net of offsetting collections and recoveries	<u>(76,602)</u>	<u>(65,722)</u>
Net obligations	(76,602)	(65,722)
Other Resources		
Imputed financing from costs absorbed by others	<u>8,524</u>	<u>9,125</u>
Net other resources used to finance activities	<u>8,524</u>	<u>9,125</u>
<i>Total resources used to finance activities</i>	(68,078)	(56,597)
<i>Resources Used to Finance Items not Part of the Net Cost of Operations:</i>		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	13,128	11,318
Unfilled Customer Orders	(17,252)	(7,511)
Resources that fund expenses recognized in prior periods	(4,073)	(767)
Resources that finance the acquisition of assets	(1,081)	(5,775)
Other	<u>24</u>	<u>6,162</u>
Total resources used to finance items not part of the net cost of operations	<u>(9,254)</u>	<u>3,427</u>
<i>Total resources used to finance the net cost of operations</i>	(77,332)	(53,170)
<i>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</i>		
Components Requiring or Generating Resources in Future Periods		
Increase in exchange revenue receivable from the public	-	(54)
Other	<u>-</u>	<u>257</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	-	203
Components not Requiring or Generating Resources		
Depreciation and amortization	24,017	6,825
Other	<u>2,046</u>	<u>1</u>
Total components of Net Cost of Operations that will not require or generate resources	<u>26,063</u>	<u>6,826</u>
<i>Total components of net cost of operations that will not require or generate resources in the current period</i>	<u>26,063</u>	<u>7,030</u>
Net Cost of Operations	\$ (51,269)	\$ (46,140)

DOCUMENT AUTOMATION AND PRODUCTION SERVICE

Document Automation and Production Service Overview

Defense Working Capital Fund

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DOCUMENT AUTOMATION AND PRODUCTION SERVICE

Overview

The Document Automation and Production Service (DAPS) manages its worldwide mission through a headquarters, located in Mechanicsburg, Pennsylvania, and a network of 80 major field locations and 176 smaller document automation facilities. DAPS is responsible for the DoD printing, duplicating, and document automation programs; encompassing value-added conversion, electronic storage and output, and the distribution of hard copy and digital information. All DoD printing requirements, whether produced in-house or procured through the Government Printing Office (GPO), are forwarded to DAPS to ensure compliance with DoD directives and the Federal Printing Program. The Congressional Joint Committee on Printing exercises oversight over all Federal printing, including DAPS in-house capability. Further, DAPS manages a worldwide printing, duplicating, and document automation production and procurement network. During FY 02, DAPS earned more than \$384 million in revenue and employed just over 1,100 people at year-end, which represents a 22 percent end strength reduction from FY 01. Major customers are Air Force (21 percent), Navy (32 percent), Army (22 percent), Defense Agencies (16 percent) and non-DoD customers (9 percent).

Mission

The mission of DAPS is to provide best value document automation and management services in support of America's Armed Forces and Federal agencies, including the capture, management, access, distribution and output of digital and hardcopy information. DAPS provides time sensitive, competitively priced, high quality products and services that are produced in-house or procured from commercial sources. DAPS is the recognized leader in document automation and the customer-preferred provider of automated digital and hardcopy information products and services. Primary focus is placed on the transition from paper to electronic-based document management,

which is an integral part of the DoD plan to move into the age of electronic documents and commercial business practices.

Strategic Goals

DAPS is committed to the following goals:

- Serving as a major catalyst in transforming business by revolutionizing document automation services;
- Rapidly utilizing technology for agile and responsive internal business solutions;
- Aggressively pursuing partnerships with Government, industry, and suppliers;
- Ensuring the DAPS workforce is enabled to deliver and sustain world-class performance;
- Striving to reduce costs, simplify organizational structure, eliminate unnecessary facilities, and ensure that equipment and personnel are commensurate with the workload; and
- Aligning our processes to focus on improving the quality of our products and services while meeting or exceeding our customers' delivery requirements.

FY 02 Major Accomplishments

- Reduction of "Aged" financial transactions. DAPS also aggressively pursued two financial goals: reduce the value of its "aged" payables and receivables - those over 120 days old. DAPS was able to reduce its aged accounts payables by more than 40 percent from \$77.2 million to \$45.7 million and its receivables by 72 percent from \$77.1 million to \$21.6 million. While the total value of accounts payables increased slightly - \$1.7 million - from FY 01 to FY 02, we see no long term risk to a rise in DAPS interest payments.
- Implemented the Most Efficient Organization (MEO). DAPS invested \$27 million – that was not

included in the original budget submission - to create and implement its MEO. Using the Office of Management and Budget (OMB) A-76 procedures, DLA solicited bids from both the private sector and DAPS for its Continental United States business. Since no private sector bids were received, the solicitation was cancelled effective September 7, 2001. On January 18, 2002, the Source Selection Authority (SSA) decided that DAPS should operate under the MEO, which was fully implemented by early November 2002. In addition to achieving the MEO, DAPS closed two offices.

Program Performance Measures

- Conversion to Digital Format - This performance metric measures the number of pages (in millions) converted to digital format during the year. Conversions may be accomplished either in-house or by contract and includes hardcopy to digital, system output to digital, and from one form of digital to another. Actual production of 62 million pages exceeded the goal of 58 million pages converted and represented an increase of 7 percent from FY 01.
- Production Efficiency Factor - This performance metric measures production efficiency in terms of units produced per hour. The units are converted to standard hours earned. Employee time is captured by cost center as hours available. The employee hours available are divided into the hours earned to produce the production efficiency factor shown as a percentage. DAPS production efficiency was over 99 percent for FY 02.
- Product Rework - In-house rework percentage is used to measure the quality of delivered products. This performance metric is calculated by dividing revenue lost from orders not accepted by the total in-house production revenue. During FY 02, DAPS achieved a rework percentage of .40 to just miss our goal of .38 percent.

Financial Performance Measures

In addition to program performance measures, DAPS measures the effectiveness of program budgeting and execution with a unit cost performance measure. It measures the total units produced relative to the total cost to produce those items.

	FY 02 Goal	FY 02 Actual
Unit Cost per In-House Production Unit	.0577	.0624

DAPS did not achieve its unit goal due primarily to incurring MEO implementation cost of \$27 million. The uncertainty of the A-76 selection decision precluded those costs from being considered in the development of the goal.

Results

DAPS projected an FY 02 Net Cost of Operations of \$.5 million, but experienced expenses that exceeded revenue by \$32.7 million. The cost, \$25.8 million, incurred to implement the A-76 decision – the Most Efficient Organization - was the primary reason for this loss.

Document Automation and Production Service Comparative Financial Statements

**AS OF AND FOR THE YEARS ENDED
SEPTEMBER 30, 2002 AND 2001**

Defense Working Capital Fund

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Comparative Balance Sheets
As of September 30, 2002 and 2001
(In Thousands)

	2002	2001
ASSETS		
Intragovernmental:		
Fund Balance with Treasury	\$ -	\$ -
Accounts Receivable	<u>86,611</u>	<u>103,935</u>
Total Intragovernmental Assets	86,611	103,935
Accounts Receivable	2,379	2,758
Inventory and Related Property	10,508	13,577
General Property, Plant and Equipment	20,221	19,032
Other Assets	<u>99</u>	<u>99</u>
TOTAL ASSETS	<u>\$ 119,818</u>	<u>\$ 139,401</u>
LIABILITIES		
Intragovernmental:		
Accounts Payable	\$ 2,456	\$ 5,981
Environmental Liabilities	-	-
Other Liabilities	<u>2,420</u>	<u>2,685</u>
Total Intragovernmental Liabilities	4,876	8,666
Accounts Payable	128,617	123,418
Military Retirement Benefits and Other Employment-Related		
Actuarial Liabilities	10,508	12,706
Environmental Liabilities	-	-
Other Liabilities	<u>5,830</u>	<u>6,375</u>
TOTAL LIABILITIES	149,831	151,165
NET POSITION		
Cumulative Results of Operations	<u>(30,013)</u>	<u>(11,764)</u>
TOTAL NET POSITION	<u>(30,013)</u>	<u>(11,764)</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 119,818</u>	<u>\$ 139,401</u>

Comparative Statements of Net Cost
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Program Costs		
Intragovernmental Gross Costs	\$ 28,250	\$ 56,259
Less: Intragovernmental Earned Revenue	<u>(381,044)</u>	<u>(383,418)</u>
Intragovernmental Net Cost	(352,794)	(327,159)
Gross Costs With the Public	388,464	340,753
Less: Earned revenue From the Public	<u>(2,974)</u>	<u>(6,808)</u>
Net Costs With the Public	<u>385,490</u>	<u>333,945</u>
Total Net Cost	<u>32,696</u>	<u>6,786</u>
Net Cost of Operations	<u>\$ 32,696</u>	<u>\$ 6,786</u>

Comparative Statements of Net Position
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002 Cumulative Results of Operations	2001 Cumulative Results of Operations
Beginning Balances	\$ (11,764)	\$ (7,261)
Budgetary Financing Sources:		
Appropriations used	100	244
Other Financing Sources:		
Transfers-in/out without reimbursement	8,290	(5,065)
Imputed financing from costs absorbed by others	<u>6,057</u>	<u>7,104</u>
Total Financing Sources	14,447	2,283
Net Cost of Operations	<u>32,696</u>	<u>6,786</u>
Ending Balances	<u>\$ (30,013)</u>	<u>\$ (11,764)</u>

Comparative Statements of Budgetary Resources
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Budgetary Resources:		
Budget Authority:		
Appropriations received	\$ 100	\$ 244
Unobligated balance:		
Beginning of period	21,463	29,306
Spending authority from offsetting collections:		
Earned		
Collected	401,931	387,860
Receivable from Federal sources	(17,640)	2,379
Change in unfilled customer orders		
Advance received	(61)	61
Without advance from Federal sources	<u>(4,142)</u>	<u>(1,021)</u>
Subtotal	380,088	389,279
Permanently not available	<u>32,515</u>	<u>(24,310)</u>
Total Budgetary Resources	<u>\$ 434,166</u>	<u>\$ 394,519</u>
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ -	\$ (139,750)
Reimbursable	<u>396,164</u>	<u>512,805</u>
Subtotal	396,164	373,055
Unobligated balance:		
Apportioned	<u>38,002</u>	<u>21,464</u>
Total, Status of Budgetary Resources	<u>\$ 434,166</u>	<u>\$ 394,519</u>
Relationship of Obligations to Outlays:		
Obligated Balance, Net - beginning of period	\$ 53,481	\$ 64,881
Obligated Balance, Net - end of period:		
Accounts receivable	(89,053)	(106,693)
Unfilled customer order from Federal sources	(21,834)	(25,975)
Undelivered orders	39,307	50,121
Accounts payable	132,747	136,028
Outlays:		
Disbursements	410,260	383,097
Collections	<u>(401,870)</u>	<u>(387,921)</u>
Subtotal	<u>8,390</u>	<u>(4,824)</u>
Net Outlays	<u>\$ 8,390</u>	<u>\$ (4,824)</u>

Comparative Statements of Financing
For the Years Ended September 30, 2002 and 2001
(In Thousands)

	2002	2001
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	\$ 396,164	\$ 373,055
Less: Spending authority from offsetting collections and recoveries	(380,088)	(389,279)
Obligations net of offsetting collections and recoveries	16,076	(16,224)
Net obligations	16,076	(16,224)
Other Resources		
Imputed financing from costs absorbed by others	6,057	7,104
Net other resources used to finance activities	6,057	7,104
<i>Total resources used to finance activities</i>	22,133	(9,120)
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet provided:		
Undelivered Orders	10,815	6,222
Unfilled Customer Orders	(4,203)	(960)
Resources that fund expenses recognized in prior periods	(2,490)	(350)
Resources that finance the acquisition of assets	(5,101)	(1,700)
Other	-	8,309
Total resources used to finance items not part of the net cost of operations	(979)	11,521
<i>Total resources used to finance the net cost of operations</i>	21,154	2,401
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in annual leave liability	4,561	-
Other	-	176
Total components of Net Cost of Operations that will require or generate resources in future periods	4,561	176
Components not Requiring or Generating Resources		
Depreciation and amortization	3,206	4,208
Revaluation of assets or liabilities	3,645	-
Other	130	-
Total components of Net Cost of Operations that will not require or generate resources	6,981	4,208
<i>Total components of net cost of operations that will not require or generate resources in the current period</i>	11,542	4,384
Net Cost of Operations	\$ 32,696	\$ 6,785



DLA Mission

To provide best value logistics support to
America's Armed Forces,
in peace and war...around the clock,
around the world.

DLA Vision

Right Item, Right Time, Right Place, Right Price.
Every Time...Best Value Solutions
For America's Warfighters.



D E F E N S E L O G I S T I C S A G E N C Y

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